Supreme Court, U.S.
FILED
MAR 22 1993
OFFICE OF THE CLERK

92-1534

No. 92-___

In The

Supreme Court of the United States

October Term, 1992

ANDREW L. SMITH,

Petitioner,

v.

R. JACK AYRES, JR.,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Has the federal common law concerning the general assignability of a federal securities fraud claim by express assignment of the claim been changed to a case-by-case fact-sensitive inquiry based on the policy concerns discussed in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975)?

2. Can the court of appeals affirm the dismissal of Plaintiff's claims based on two fact-sensitive inquiries not argued by the Defendant and not relied upon by the district court in dismissing Plaintiff's claims, and for which Plaintiff was not accorded a full and fair opportunity to provide controverting evidence?

3. Where a district court erroneously dismisses Plaintiff's federal claim, and in connection therewith dismisses Plaintiff's pendent state law claims for lack of federal jurisdiction pursuant to *United Mine Workers v. Gibbs*, 383 U.S. 715, 727 (1966), is it necessary for the court of appeals to formally remand the pendent state law claims along with the erroneously dismissed federal question claim in order for the district court upon remand to reacquire pendent jurisdiction over the state law claims?

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OPINIONS BELOW

This petition seeks review of a decision of the United States Court of Appeals for the Fifth Circuit, which is reported at 977 F.2d 946 and reprinted as Appendix A.[1] The Memorandum Order of the United States District Court for the Northern District of Texas, Dallas Division (Fish, J.) is unreported and reprinted as Appendix B. The judgment dismissing Plaintiff's claims is reprinted as Appendix C.

[1] References to the appendices will be styled "A ___".

JURISDICTION

The decision and judgment of the court of appeals were entered on November 23, 1992. A timely petition for rehearing was denied on December 21, 1992. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATEMENT OF THE CASE[2]

This case involves the fraudulent conduct by Defendant R. Jack Ayres, Jr. ("Ayres") and his co-conspirators, Clayton J. Smith ("Clayton") and Mark L. Smith ("Mark"), in connection with the issuance of 26% of the stock of Smith Protective Services, Inc. ("SPS" or the "Company") to Clayton. Andrew, both individually and derivatively on behalf of SPS, brought suit against (1) Ayres, who was the corporate attorney for SPS and the mastermind of the stock fraud scheme; and (2) Clayton and Mark, who conspired with Ayres to defraud SPS into reissuing stock to Clayton for the purpose of shifting control of the Company away from Andrew and Mrs. Smith over to Clayton and Mark.

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[2] The district court granted the Defendant's Supplemental Motion to Dismiss. (A2). The facts as stated herein are supported by Plaintiff's Second Amended Complaint and the summary judgment evidence submitted by Plaintiff in opposition to Defendant's Motion for Summary Judgment, with all justifiable inferences to be drawn in Plaintiff's favor. *H.J., Inc. v. Northwestern Bell Telephone Co.*, 492 U.S. 229, 249-50 (1989); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255 (1986). Although the Fifth Circuit's opinion repeatedly refers to this suit as a "class action" (A1, 2 & 10), this is not a class action and no class action allegations were made by Plaintiff.

In 1977 the shareholders of SPS were Andrew, with 26% of the stock; Andrew's mother, Coralie C. Smith, with 22%; and Andrew's brothers, Clayton and Mark, each with 26% of the stock. In June of 1977 Mrs. Smith, Andrew and Mark discovered that Clayton had embezzled over $50,000 from SPS. Accordingly, SPS had its regular outside counsel, Ayres, file suit on behalf of the Company against Clayton to recover the embezzled funds. Thereafter, Ayres, on behalf of SPS, and Clayton's independent counsel, James J. Robertson, negotiated a settlement of the Company's embezzlement claims against Clayton. As part of the settlement Clayton agreed to sell his SPS stock back to the Company.

After completing the stock redemption, Andrew and Mark each held 35% of the outstanding shares, while Mrs. Smith held 30%. With their combined majority stake, Andrew and his mother had effective control of SPS.

In early 1983 numerous conflicts developed between Mark and Andrew over Mark's management of the Dallas office of SPS, and Mark was searching for ways to get Andrew out of control of the Company. So Mark turned to the Company attorney, Ayres, for guidance on what to do about Andrew's control over SPS. As a result of his conferences with Ayres, Mark learned that one way to change management of the Company was to change ownership of the Company, and that if the SPS board voted to "rescind" the 1977 stock redemption transaction whereby Clayton sold his stock back to SPS, majority control of SPS would shift from Andrew and Mrs. Smith to Mark and Clayton.

During that same period a fee dispute developed between Andrew and Ayres over fees that Ayres claimed were due by SPS. Just before the crucial July 22 board of directors meeting, Ayres and Andrew did not get along, and Ayres, like Mark, wanted Andrew out of control of SPS. Ayres knew that if Clayton could get his stock back voting control of SPS would shift from Andrew and Mrs. Smith to Clayton and Mark.

In July of 1983 a plan was developed by Clayton, Mark and Ayres to reissue SPS stock to Clayton and thereby wrest control of SPS away from Andrew and Mrs. Smith. In April of 1983 the SPS board of directors had been expanded beyond the Smith family (Mrs. Smith, Andrew and Mark) to include six other individuals, for a total of 9 directors. Mr. Shelby Denney was elected to the board, and he subsequently became chairman of the board and president of SPS.

On the night of July 14, 1983 Mr. Denney received a conference call at his house from Clayton and Mark. Clayton and Mark asked Mr. Denney to call Ayres the next morning to discuss various options for the reissuance of SPS stock to Clayton. Mr. Denney tape-recorded his subsequent telephone conversations with Clayton and Ayres about their plans for the reissuance of SPS stock to Clayton.

Clayton and Mark wanted Ayres to take a "friendly lawsuit" down to the courthouse and have an agreed judgment on Clayton's stock ownership entered before the issue was ever addressed by the SPS board. Mr. Denney rejected this plan, and expressed his belief that the issue probably would carry the board of directors

unless Mrs. Smith and Andrew, as majority shareholders, dissolved the board of directors. Clayton wanted Mr. Denney to review the various options with Ayres, but not to mention anything about the plan to anyone else, including fellow board member Ira Tobolowsky. As stated by Clayton to Mr. Denney, "before we settle on an option, I want it reviewed with [Ayres], to get his input, to make certain that we're not encumbering ourselves in some way that we can avoid."

When Mr. Denney insisted that the matter be fully discussed with the SPS board of directors, Clayton outlined the problems of advance notice:

> *Clayton J. Smith*: I don't have any problem with the board. There's only one fly in the ointment, and that's Andy. And Andy, even though crazy, is not stupid. And he's pretty well informed on legal matters. . . . *I need to talk to Jack.* I want to delve into some legal technicalities with him. . . . You see, I'm a layman right now, but in lay point of view, *I have a question of Jack Ayres* of what type of exposure we have by allowing the board of directors to vote on it, and then going down to the courthouse to finalize it. . . . [A]nd I'd just *have to talk to Jack* and see if I'm talking fairy tales or something that's accurate.

On July 19 at approximately 6:30 a.m. Clayton met with Ayres at Ayres' office to flesh out the final details of Ayres' plan for Clayton to get his stock back. Obviously Ayres could not represent Clayton directly, so they needed a friendly and cooperative outside attorney who could serve as the messenger and deliver a demand letter to the SPS board to set the whole process in motion. So

Ayres decided that Clayton would engage Gerry Wren, Esq., a close personal friend of Ayres.

With Clayton sitting right at Ayres' side, at 7:00 a.m. on July 19 Ayres got Mr. Wren on the speaker phone to talk about the claims that Ayres wanted Wren to make on behalf of Clayton against Ayres' own client, SPS. Ayres told Mr. Wren that he (Ayres) wanted a formal written demand letter on behalf of Clayton so that he (Ayres) could present the letter and the stock issue to the SPS board at its July 22 meeting.

Friday, July 22 arrived, but the demand letter from Mr. Wren didn't. On that day Mr. Wren had left town on a personal matter; was out of contact with his office; and had not as yet prepared the demand letter requested by Ayres. Upon being informed that Mr. Wren had left town without preparing the requested demand letter, Ayres decided that he would prepare the demand letter on his own. So Ayres dictated a phony "demand letter" to himself, as counsel for SPS, demanding that the 1977 stock redemption transaction be rescinded, and that the repurchased shares of SPS stock be returned to Clayton. However, Ayres' demand letter to himself was typed on the letterhead of another law firm (Brice & Barron) over the purported signature of Gerry N. Wren, as ostensible counsel for Clayton (the "Wren Letter"). Further, to be certain to seal the fate on the reissuance of SPS stock to Clayton, Ayres inserted a bogus 5:00 p.m. deadline in the demand letter to himself that had never been discussed with Mr. Wren, Clayton or anybody else.

At the July 22 board meeting Ayres presented the Wren Letter to the directors and doggedly argued that if

the SPS stock was not returned to Clayton, Clayton would prevail in a lawsuit for actual and punitive damages. Ayres strongly recommended to the SPS board that they capitulate to the demands made in the Wren Letter, but at no time did Ayres disclose that he contrived the whole Wren Letter scheme.

Ayres stated in the demand letter to himself that:

> Unless an agreement in principle has been reached between my client and your client on mutually agreed terms before the close of business today at 5:00 p.m., I have been instructed to proceed with suit. It has been my advice to my client that if suit is filed no further settlement efforts should be undertaken.

After the Wren Letter was distributed to the board members Ayres told the SPS board that *"[Mr. Wren's] letter embodies some things that he [Mr. Wren] has not said to me by phone."* But Ayres dictated the letter, not Mr. Wren. According to Mr. Tobolowsky, "Jack Ayres made an impassioned and compelling argument to the Board of Directors that we should vote to give Clayton back his stock", and "Mr. Ayres made me and the other directors . . . very concerned about the potential for individual liability unless the directors voted to rescind the 1977 Transaction and return Clayton's stock to him." However, Ayres did not tell the SPS board that he, not Mr. Wren, had inserted the phony 5:00 p.m. deadline in the demand letter, and that he had never discussed any such supposed deadline with Mr. Wren or anybody else.

Paying homage to a false 5:00 deadline that he had imposed himself, Ayres represented to the SPS board:

> The problem that I'm talking about is, I'm talking about is, if you're going to take that action, I think we're going to hurt ourselves more by waiting, because *I have until 5:00 today,* that's two and a half hours, *to call Wren and tell him,* and I – all I'm saying is, whatever you do, I don't want to be left in the middle of this thing with it hanging, because otherwise you're going to get the worst of both worlds. You're going to get sued and you're not going to be able to settle this lawsuit, if he means what he says.

Staring down the barrel of a purported 5:00 deadline, and without time for independent analysis or reflection, the board of directors of SPS acceded to Ayres' demand in the Wren Letter and was tricked into voting 5 to 2 (with two abstentions) to rescind the prior repurchase of Clayton's stock. Mrs. Smith and Andrew (owners of 65% of the stock of SPS) voted against the rescission.

The false authorship of the demand letter was not the boundary of the fraud. Indeed, Ayres never disclosed to the SPS board that (1) the statements made by Ayres in the demand letter to himself were false; (2) the purported 5:00 deadline inserted by Ayres in the demand letter was bogus and was simply used by Ayres to stampede the SPS board into immediate and uninformed action so Andrew and Mrs. Smith would not have time to call a shareholder's meeting to elect a new slate of directors; (3) all of Clayton's 5 year 10 month old claims were barred by limitations; and (4) the claims of Clayton were concocted by Ayres as a tool to get the SPS board to reissue stock to Clayton and to remove Andrew and Mrs. Smith from a position of control with the Company.

The fraudulently induced July 22, 1983 resolution of SPS acknowledged the receipt of what appeared to be a legitimate demand letter prepared by what appeared to be Clayton's independent counsel, and noted the existence of what appeared to be a real and definite 5:00 p.m. deadline to take action on the matter before suit would be filed by Clayton. That resolution and the purported rescission of the 1977 stock redemption transaction diluted the stock ownership of Andrew and Mrs. Smith from 65% to 48%, and immediately placed Clayton and Mark in control of SPS. Thereafter, corporate raiders Clayton and Mark used SPS as their personal fiefdom; looted the corporate coffers; and wasted millions of dollars in corporate assets.

But the inter-family squabble continued over ownership and control of SPS. When it became apparent that Andrew would not relent in his efforts to restore competent management to SPS, on October 31, 1983 Ayres had SPS add Andrew as an additional party defendant to a lawsuit styled *Smith Protective Services, Inc. v. Cimaglia, et al.*, a suit that Andrew previously had Ayres initiate over three years earlier which was still pending in Judge Dee Brown Walker's court.

There was no legal or factual basis for adding Andrew as a party-defendant to the *Cimaglia* suit. In fact, Andrew was only added as a party-defendant to the *Cimaglia* suit under trumped-up allegations of a conspiracy with the Cimaglias so that Ayres could arrange to have Andrew brought before Judge Dee Brown Walker for the very reasons summarized in *Browning v. Navarro*, 826 F.2d 335, 345 (5th Cir. 1987).

In January of 1984 Andrew discovered that Ayres was the true author of the Wren Letter and that Ayres, Clayton and Mark had conspired to reissue SPS stock to Clayton. After confronting Clayton with this discovery, Ayres immediately obtained an interlocutory default judgment against Andrew in the *Cimaglia* suit (Judge Dee Brown Walker's court), which included a judicial declaration of Clayton's stock ownership in SPS, even though no such request was made in any of the underlying pleadings and Clayton was not even a party to the suit. Thereafter, Ayres obtained from former Judge Walker a "nunc pro tunc" judgment which not only purported to establish Clayton as a shareholder in SPS, but it also purported to completely divest Andrew as a shareholder in SPS. *See Smith Protective Services v. Martin*, 711 S.W.2d 675, 676-79 & 681-82 n. 1 (Tex.App. – Dallas 1986, no writ). As admitted by Ayres when he first hatched the whole fraudulent scheme:

> I'm simply saying that – that the idea of litigation . . . lends an air of finality to it that might help us insofar as Andrew is concerned, because it's my belief that ultimately, . . . when all these things come to pass, . . . *I think Andrew will probably end up suing all of us.* . . . And so therefore, . . . *I'm simply suggesting that [litigation] mechanism as a protective device.*

In reliance on the representations of Ayres about the supposedly meritorious claims of Clayton which were supposedly not barred by limitations, and which supposedly had to be acted on by 5:00 that day, on July 22, 1983 SPS reissued 26% of its stock to Clayton. Had the disinterested members of the SPS board known that there was any collusion between Ayres and Clayton or Mark

pertaining to the claims of Clayton, the board would *not* have voted in favor of the reissuance of SPS stock to Clayton. Further, had the members of the SPS board known that Clayton's claims were either not meritorious in fact, or barred by limitations, the SPS board would *not* have voted in favor of the reissuance of SPS stock to Clayton. In addition, had the members of the SPS board known that there was no real 5:00 deadline as represented by Ayres, the board would *not* have voted in favor of the reissuance of SPS stock to Clayton, but would have voted in favor of an extension so the allegedly "urgent" matter could be investigated and researched further.

Under fear of personal liability, and with the belief that the 5:00 deadline was a true and serious deadline imposed by Clayton's independent attorney, the SPS board was stampeded into reissuing stock to Clayton by the close of business on July 22, 1983. The false 5:00 deadline had accomplished the desired result.

Andrew filed this individual and derivative securities fraud suit on December 31, 1985. Andrew alleged that the Defendants' fraudulent conspiracy was in violation of (a) § 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)) and Rule 10b-5 promulgated thereunder (17 CFR § 240.10b-5) ("Rule 10b-5") and (b) § 1962(b) of the Racketeer Influenced and Corrupt Organizations Act (18 U.S.C. §§ 1961 *et seq.*), and also constituted fraud, civil conspiracy, tortious interference with corporate governance rights, and breach of fiduciary duties under the common law of Texas. The Defendants' motions to dismiss were granted, in part, by the lower court on March 18, 1987. In addition to dismissing Plaintiff's federal claims, the district court dismissed Plaintiff's pendent

claims because the district court was of the erroneous belief that there was no federal cause of action upon which the pendent claims could attach.

Upon the prior appeal, the Fifth Circuit affirmed the dismissal of Plaintiff's individual federal securities fraud claim and RICO claim; affirmed the dismissal of the conspiracy claims against Clayton and Mark; but "reverse[d] the dismissal of the derivative claim" against Ayres. *Smith v. Ayres*, 845 F.2d 1360, 1361 (5th Cir. 1988).[3] On December 13, 1989 Andrew and his mother settled their claims against SPS, Clayton and Mark, and executed an agreement reflecting the terms of the settlement. As part of the settlement, SPS agreed to "assign and convey to Andrew" its claims or causes of action against Ayres, and permitted Andrew "the right to bring [suit] in the name of the corporation for such claims, including the right to substitute the name of the corporation for the plaintiff in the pending derivative suit now filed in the name of Andrew L. Smith."[4]

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[3] At the time of the prior appeal, neither Plaintiff nor the Fifth Circuit were aware of the tape recorded conversations between Mr. Denney and Ayres and Clayton (Px 2) which confirmed the details of the conspiracy among Ayres, Clayton and Mark to reissue 26% of SPS stock to Clayton and thus shift control of SPS from Andrew and his mother to Clayton and Mark.

[4] Rule 25(c), Fed.R.Civ.P., provides that when there has been a transfer or assignment of an interest in a case, "the action may be continued by or against the original party, unless the court upon motion directs the person to whom the interest is transferred to be substituted in the action or joined with the original party." As noted in 7C Wright, Miller & Kane, *Federal Practice and Procedure* § 1958 p. 555 (1986), "[t]he most

Upon remand, Ayres again moved to dismiss the Complaint, which was granted by the district court on April 12, 1991. On November 23, 1992 the Fifth Circuit issued its Opinion affirming the dismissal of Plaintiff's claims on the basis of two fact-sensitive inquiries *not* argued by the Defendant or relied upon by the district court, and for which Plaintiff was not accorded a full and fair opportunity to provide controverting evidence.

REASONS FOR GRANTING THE WRIT

As part of the settlement of Andrew's claims against SPS, Clayton and Mark, SPS expressly assigned its claims against Ayres to Andrew and granted Andrew the right to sue as assignee of such claims. The trial court, however, dismissed Plaintiff's complaint, "ruling that Rule 10b-5 securities fraud actions are not assignable." (A3). The Fifth Circuit affirmed the decision of the trial court by applying a novel fact-sensitive test gleaned from *Blue Chip Stamps v. Manor Drug Store*, 421 U.S. 723 (1975). The question of the assignability of a Rule 10b-5 securities fraud claim is an important question of federal law which has not been, but should be, settled by this Court.

Further, the court of appeals affirmed the district court's dismissal of Plaintiff's claims based on two fact-sensitive inquiries neither argued by the Defendant nor utilized by the district court in ruling that Andrew could not proceed as the assignee of SPS' securities fraud

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significant feature of Rule 25(c) is that it does not require that anything be done after an interest has been transferred."

claims. Plaintiff was never accorded the opportunity to develop facts relevant to those two allegedly dispositive fact-sensitive inquiries. The sua sponte "findings of fact" by the court of appeals denied Plaintiff his day in court as to a disputed part of the case on which the trial court has never ruled, in conflict with this Court's decisions in *Fountain v. Filson*, 336 U.S. 681, 683 (1949); *Florida Lime and Avocado Growers, Inc. v. Paul*, 373 U.S. 136, 156 (1963); and *Byrd v. Blue Ridge Rural Electric Cooperative*, 356 U.S. 525, 533 (1958).

Finally, both the district court and the Fifth Circuit refused to acknowledge the pendency of Plaintiff's pendent claims. In effect the Fifth Circuit ruled that unless a court of appeals expressly remands a plaintiff's pendent claims, the pendent claims are fragmented from the remanded federal question claim, and are not again before the district court along with the remanded federal question claim. The question of the power of the district court to entertain a plaintiff's pendent claims along with the expressly remanded federal question claim is an important question of federal law which has not been, but should be, settled by this Court.

I. THE POLICY CONCERNS OF *BLUE CHIP STAMPS* DO NOT APPLY TO THE ASSIGNABILITY OF RULE 10b-5 CLAIMS BY A DEFRAUDED SELLER OF SECURITIES

Ayres argued in the district court and on appeal to the Fifth Circuit that "claims arising under Rule[] 10b-5 are personal to the injured party", and as such are not assignable. The district court misconstrued the nature of

Plaintiff's claims and ruled that "[Andrew] may not sue as the assignee of the other shareholders' derivative claims." (A17 n.*). The Fifth Circuit disregarded both of those arguments, and affirmed the dismissal of Plaintiff's claims by applying a novel fact-sensitive test gleaned from *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) to invalidate the assignment of SPS' securities fraud claims to Andrew. (A6-9).

As part of the settlement agreement between Andrew and SPS, "SPS expressly assigned any and all claims against Ayres to Andrew and granted Andrew the right to sue as assignee of such claims." (A2). While a Rule 10b-5 claim must be predicated on an actual purchase or sale of securities as required by *Blue Chip Stamps*, 421 U.S. at 731, so long as the assignor has *Blue Chip Stamps* standing, the express assignee of a Rule 10b-5 claim has *Blue Chip Stamps* standing as well. *AmeriFirst Bank v. Bomar*, 757 F.Supp. 1365, 1370-72 (S.D.Fla. 1991); *Gardner v. Surnamer*, 608 F.Supp. 1385, 1390 (E.D.Pa. 1985); *see, generally*, Note, *Express Versus Automatic Assignment of Section 10(b) Causes of Action*, 1985 Duke L.J. 813, 823 & 828-30 (1985) ("*Duke L.J.*"). Accordingly, to determine the standing of Andrew as assignee, the Court need look no further than the standing of the assignor, SPS.

The federal securities statutes contain no specific provision regarding the assignment of a cause of action under Rule 10b-5. 3 L. Loss *Securities Regulation* p. 1817 (2d Ed. 1961). In the absence of a specific statutory directive, whether a federal statutory claim can be assigned is governed by the federal common law. *Id.; Lowry v. Baltimore & Ohio R.R. Co.*, 707 F.2d 721, 727-28 (3d Cir. 1983) (en banc) (Garth, J. concurring); *cf. Smith v. No. 2*

Galesburg Crown Finance Corporation, 615 F.2d 407, 413 (7th Cir. 1980); *Spiller v. Atchison, T. & S.F. Ry. Co.*, 253 U.S. 117, 135 (1920). Although a fraud action personal in nature (such as seducement) may not be assignable, a fraud claim is assignable where it is regarded as an injury to property. *Comegys v. Vasse*, 26 U.S. 193, 213 (1828); *see, generally*, 6A C.J.S. *Assignments* § 40 p. 649 (1975); *Duke L.J.* pp. 815-18. The federal common law is that a Rule 10b-5 claim by a defrauded corporate seller of securities "is not one personal [but rather] is as a matter of law an injury to property." *Hooper v. Mountain States Securities Corporation*, 282 F.2d 195, 206-07 (5th Cir. 1960). Accordingly, an express assignment of a Rule 10b-5 claim by a defrauded corporate seller of securities is effective. *Id.*; *Lowry*, 707 F.2d at 726 n. 7 (Garth, J., concurring) (citing cases); *AmeriFirst*, 757 F.Supp. at 1372; *Gardner*, 608 F.Supp. at 1390.

The "purchase or sale" requirement of *Blue Chip Stamps* is not a barrier to Andrew's standing as assignee of the Rule 10b-5 claims of SPS against Ayres. As previously decided by the Fifth Circuit, SPS was a defrauded seller of securities with *Blue Chip Stamps* standing. *Smith v. Ayres*, 845 F.2d at 1364 & n. 14.

The concern of this Court in *Blue Chip Stamps* was not whether an actual defrauded seller of securities could assign its Rule 10b-5 claims. *Gardner*, 608 F.Supp. at 1392-93; *AmeriFirst*, 757 F.Supp. at 1372. Rather, this Court in *Blue Chip Stamps* limited Rule 10b-5 plaintiffs to those who actually purchased or sold securities based on the defendant's deceit (as opposed to those who claimed that they would have bought or sold securities but didn't) because of concern over "what is and is not manageable

in the litigation of facts. . . . " *Virginia Bankshares, Inc. v. Sandberg*, ___ U.S. ___, ___, 111 S.Ct. 2749, 2757 (1991).

Without limiting Rule 10b-5 plaintiffs to actual purchasers or sellers of securities, a plaintiff would be free to dream up hypothetical securities transactions that he allegedly would have made but for the defendant's deceit. *Blue Chip Stamps*, 421 U.S. at 743. With those hypothetical non-transactions, the plaintiff's version of what he would have bought or sold would not be subject to objective verification, and the jury would be forced to decide "hazy issues of historical fact the proof of which [would depend] almost entirely on oral testimony." *Id.*

These policy concerns over "what is and is not manageable in the litigation of facts" are not implicated when an actual defrauded seller of securities with concrete proof of the sale (such as SPS) expressly transfers its securities fraud claims to an assignee. In other words, the *Blue Chip Stamps* policy concerns are not implicated where there is an actual sale of securities. *AmeriFirst*, 757 F.Supp. at 1372; *Gardner*, 608 F.Supp. at 1393. Accordingly, so long as the assignor has *Blue Chip Stamps* standing, an express assignee of those claims has standing under Rule 10b-5 as well.

II. THE FIFTH CIRCUIT ERRONEOUSLY AFFIRMED THE RESULT OF THE DISTRICT COURT BASED ON TWO FACT-SENSITIVE CONSIDERATIONS WHICH WERE NOT ARGUED BY THE DEFENDANT OR UTILIZED BY THE DISTRICT COURT IN INVALIDATING THE ASSIGNMENT OF SPS' RULE 10b-5 CLAIMS

The district court dismissed Plaintiff's securities fraud claims by granting the Defendant's supplemental

motion to dismiss. (A2, 11 & 19). In affirming the dismissal of this case, the Fifth Circuit ruled that the two policy concerns discussed in *Blue Chip Stamps* to limit standing for Rule 10b-5 actions to actual purchasers or sellers of securities guided its decision here that SPS could not assign its Rule 10b-5 claims to Andrew. (A6-9). Those two policy factors were (1) concern about strike suits or nuisance suits; and (2) concern over evidentiary problems where a plaintiff must depend on his own self-serving testimony to prove his case. (*Id.*).

These factors were not argued by Ayres or utilized by the district court in ruling that Andrew could not proceed as the assignee of SPS' securities fraud claims. The district court made no finding that Plaintiff's securities fraud suit against Ayres lacked merit or that Plaintiff's proof was dependent upon Andrew's self-serving testimony. Indeed, the district court never even discussed the alleged lack of merit of the securities fraud claims against Ayres or Plaintiff's supposed dependence upon the self-serving testimony of Andrew to prove Ayres' fraudulent conduct.

Rather, Ayres argued in the district court that "claims arising under Rule[] 10b-5 are personal to the injured party", and as such are not assignable.[5] After we pointed

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[5] Without supporting evidence, Ayres made the conclusory statement that this case was a "strike suit" in connection with his argument that Andrew was not an adequate representative to proceed with a *derivative* suit under Fed.R.Civ.P. 23.1. However, Ayres never argued, and the district court never ruled, that the Rule 10b-5 claim of SPS against Ayres was not assignable to Andrew because the underlying suit was supposedly a strike

out to the district court that the Fifth Circuit in *Hooper*, 282 F.2d at 206-07 had ruled just the opposite, the district court dismissed Plaintiff's complaint by ruling that "[Andrew] may not sue as the assignee of the other shareholders' derivative claims." (A17 n.*). Moreover, the district court expressly stated that its judgment of dismissal was entered "[f]or the reasons stated in the Court's April 12, 1991 Memorandum Order granting the [Defendant's] Supplemental Motion to Dismiss. . . . " (A20). After we advised the district court that Andrew never contended that he could proceed with this suit "as the assignee of the other shareholders' derivative claims", the district court denied Plaintiff's motion for reconsideration, without explanation, even though Ayres could not muster a response to the motion.

Upon appeal we pointed out to the Fifth Circuit that Andrew never contended that he could proceed with this suit "as the assignee of the other shareholders' derivative claims." The Fifth Circuit, however, affirmed the result of the district court *not* because "claims arising under Rule 10b-5 are personal to the injured party", and as such are not assignable (as argued by Ayres); and *not* because "[Andrew] may not sue as the assignee of the other shareholders' derivative claims" (as decided by the district court). Rather, the Fifth Circuit affirmed the district court's dismissal of Plaintiff's suit based on two fact-sensitive factors, neither of which were argued by the Defendant or relied upon by the district court in determining that Andrew could not proceed as the assignee of

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suit peculiarly dependent upon the testimony of Andrew to prove the claims.

SPS' securities fraud claims, and neither of which Plaintiff was accorded the opportunity to controvert in the district court.

Indeed, in affirming the district court's decision, the Fifth Circuit ignored the merits of Plaintiff's claims and looked solely to the animosity that Andrew felt toward Ayres to erroneously conclude that "this action bears all the hallmarks of a strike or nuisance suit. . . . " (A8). However, a strike suit or a nuisance suit is not based on the animosity or personal antagonisms a plaintiff has for a defendant. *Cf. Vanderbilt v. Geo-Energy Ltd.*, 590 F.Supp. 999, 1001 (E.D.Pa. 1984) (residual contentiousness and discordant relationship between plaintiff and defendant may inspire the plaintiff to be an even more forceful advocate). Rather, a strike suit or a nuisance suit is based on the manifest lack of merit of the underlying claim. As noted by this Court in *Surowitz v. Hilton Hotels Corporation*, 383 U.S. 363, 371 (1966), a strike suit is a suit

> by people who might be interested in getting quick dollars by making charges without regard to their truth so as to coerce corporate managers to settle worthless claims in order to get rid of them.

See, also, Cohen v. Beneficial Loan Corp., 337 U.S. 541, 548 (1949).

Further, the Fifth Circuit ignored the transcript of the tape recorded conversations between Mr. Denney (the former president of SPS) and Clayton and Ayres (Px 2) (which proves the scheme to reissue SPS stock to Clayton); ignored the transcript of the tape recorded July 22, 1983 board of directors' meeting (Px 37) (which proves

the masterful execution of the stock fraud scheme by Ayres); and ignored the affidavit (Px 34) and deposition (Px 38) of Ira Tobolowsky, Esq. (which corroborate the allegations in the Complaint) to erroneously conclude that "Andrew must necessarily rely heavily on his own 'self-serving testimony' " to prove the merits of this case. (A9).

While an appellate court may affirm the decision (if correct) of a trial court even though the trial court relied on the wrong reason in reaching its result (*Fountain v. Filson*, 336 U.S. 681, 683 (1949); *Heirs of Fruge v. Blood Services*, 506 F.2d 841, 844 n. 2 (5th Cir. 1975)), an appellate court may not do so where the aggrieved party was not accorded a "full and fair opportunity to develop facts relevant to the decision." *Id.* Since Ayres never argued, and the district court never ruled, that the securities fraud claims of SPS were not assignable to Andrew because this was supposedly an unmeritorious strike suit and the proof of Ayres' securities fraud was supposedly peculiarly dependent upon Andrew's self-serving testimony, we were never accorded a "full and fair opportunity to develop facts relevant to the decision."

The Fifth Circuit's affirmance based on two fact-sensitive factors which were not argued by the Defendant or utilized by the district court in invalidating the assignment of SPS' Rule 10b-5 claims to Andrew deprived Plaintiff of the opportunity to develop facts relevant to the Fifth Circuit's decision. Where this "full and fair opportunity" was not made available, "the proper resolution of the appeal is not affirmance but remand." *Heirs of Fruge*, 506 F.2d at 844 n. 2. At no time were we accorded the opportunity to develop facts relevant to those two

allegedly dispositive fact-sensitive inquiries. Accordingly, the sua sponte "findings of fact" by the Court of Appeals denied Plaintiff his day in court as to a disputed part of the case on which the trial court has never ruled. *Florida Lime and Avocado Growers, Inc. v. Paul*, 373 U.S. 136, 156 (1963); *Byrd v. Blue Ridge Rural Electric Cooperative*, 356 U.S. 525, 533 (1958).

III. THE FIFTH CIRCUIT'S DECISION IS NOT ONLY WRONG IN THIS CASE, IT IS BAD LAW

In the absence of a statutory directive to the contrary (*Spiller v. Atchison, T. & S.F. Ry. Co.*, 253 U.S. 117, 135 (1920); 6A C.J.S. *Assignments* § 42 p. 652 (1975)), the validity of an assignment of a fraud claim is based on an objective standard: the "property" versus "personal" aspect of the claim. *Hooper*, 282 F.2d at 206-07; *Comegys v. Vasse*, 26 U.S. 193, 213 (1828); *see, generally*, 6A C.J.S. *Assignments* § 40 p. 649 (1975); *Duke L.J.*, pp. 815-18. Under the Fifth Circuit's novel approach, each district court judge will be faced with a motion to dismiss in each case where there is an assigned securities fraud claim, with each defendant contending that the suit is nothing more than an unmeritorious strike suit dependent upon the plaintiff's self-serving testimony to prove the claim.

Is there supposed to be an evidentiary hearing? How much animosity that the plaintiff feels for the defendant will be too much and thus serve to invalidate the assignment? Further, who bears the burden of showing that the Rule 10b-5 claim is peculiarly dependent upon the plaintiff's self-serving testimony? And how much corroborating evidence is required? Is one witness enough? How

much documentary evidence must be shown? In short, every case involving an assignment of a securities fraud claim would lead to a claim by the defendant that the assignment was not effective because the suit is nothing more than an unmeritorious strike suit peculiarly dependent upon the self-serving testimony of the plaintiff to prove the claim.

The Fifth Circuit's decision only beclouds an aspect of 10b-5 litigation which deserves clarification and elucidation. *See Lowry v. Baltimore & Ohio R.R. Co.*, 707 F.2d 721 (3d Cir. 1983) (*en banc*), *cert. denied*, 464 U.S. 893 (1983). With the power of the district court to require a bond or security for costs and expenses (including attorney's fees), and the reality of sanctions under Fed.R.Civ.P. 11, there are already sufficient procedures in place to handle the wrongful prosecution of an unmeritorious strike suit. The Fifth Circuit's decision only adds an unnecessary layer of uncertainty.

Ultimately the bad law reflected by the Fifth Circuit's opinion will be visited upon many of the trial and appellate judges in our federal court system. The slippery slope subjective test announced by the Fifth Circuit is not only wrong under the facts of this case, it is bad law.

IV. THE FIFTH CIRCUIT AND THE DISTRICT COURT REFUSED TO ACKNOWLEDGE THE PENDENCY OF PLAINTIFF'S PENDENT CLAIMS

Neither the Fifth Circuit in *Smith v. Ayres I* nor the district court in its prior dismissal of this case reached the merits of Plaintiff's pendent state law claims. Rather, in March of 1987 there was the conditional dismissal of

Plaintiff's pendent claims by the district court for lack of jurisdiction because the district court was of the erroneous belief that there was no federal claim upon which the pendent claims could attach. The district court in its prior reversed order simply ruled that:

> The remaining claims asserted by [Plaintiff] arise only under state law. Since the court has determined that the securities fraud claim and RICO claim should be DISMISSED, the pendent claims must also be DISMISSED since there is no basis for federal jurisdiction.

Because of the conditional nature of the prior dismissal of the pendent claims, the Fifth Circuit's prior reversal of the condition in *Smith v. Ayres I* necessarily removed the basis by which the lower court dismissed the pendent claims. The reversal of the dismissal of one of the federal claims necessarily reverses the dismissal of the pendent claims for lack of federal jurisdiction. *Donahue v. Windsor Locks Board of Fire Commissioners,* 834 F.2d 54, 59 n. 2 (2d Cir. 1987); *Sun Savings & Loan Association v. Dierdorff,* 825 F.2d 187, 189 n. 1 (9th Cir. 1987); *Ouaknine v. MacFarlane,* 897 F.2d 75, 84 (2d Cir. 1990).

Although the pendency of Plaintiff's pendent claims was expressly brought to the district court's attention, the district court refused to acknowledge the existence of Plaintiff's pendent claims and simply dismissed Plaintiff's Complaint. Here the Fifth Circuit erroneously ruled that:

> Andrew's state law claims are not properly before this court, having been dismissed earlier in the action and such dismissal upheld by a prior panel. *See Smith v. Ayres,* 845 F.2d at 1366

> (dismissal of all claims affirmed, save only the derivative claim).

(A10 n. 2). But the district court's conditional dismissal of Plaintiff's pendent claims was not affirmed in *Smith v. Ayres I*, whether at page 1366 or any other page in the prior Fifth Circuit opinion. Accordingly, upon remand the district court was reinvested with complete judicial authority to hear the whole case – the expressly remanded federal securities fraud claim *and* the pendent state law claims expressly set forth in Plaintiff's complaint.

In effect the Fifth Circuit has ruled that if the prior appellate decision does not expressly remand the pendent state law claims, then the whole constitutional case is fragmented, with only the expressly remanded federal question claim, and not the "whole case", being remanded to the district court for consideration. The decision of the Fifth Circuit runs contrary to the basic notion of pendent jurisdiction which encourages the federal courts to hear the whole case where the federal and state claims arise from a common nucleus of operative facts.

> Pendent jurisdiction, in the sense of judicial *power*, exists whenever there is a [federal question] claim . . . and the relationship between that claim and the state claim permits the conclusion that the entire action before the court comprises but one constitutional "case." . . . But if, considered without regard to their federal or state character, a plaintiff's claims are such that he would ordinarily be expected to try them all in

> one judicial proceeding, then, assuming substantiality of the federal issues, there is *power* in federal courts to hear the whole.

United Mine Workers v. Gibbs, 383 U.S. 715, 725 (1966). The justification for pendent jurisdiction "lies in considerations of judicial economy, convenience and fairness to litigants. . . . " *Id.* at 726. *See, also, Carnegie-Mellon University v. Cohill*, 484 U.S. 341, 349 (1988).

Ayres argued that Plaintiff's pendent state law claims were not again before the district court upon the prior reversal because Plaintiff did not specifically raise on appeal any error in connection with the district court's conditional dismissal of the pendent claims. However, a district court's dismissal, without prejudice, of a party's pendent claims is vested in the sound discretion of the trial court. *Gibbs*, 383 U.S. at 726. Accordingly, the district court's conditional dismissal of Plaintiff's pendent state law claims upon the dismissal of Plaintiff's federal claim was not clearly erroneous in and of itself, thus leaving no issue to appeal on that point.

Upon remand, however, Plaintiff's Second Amended Complaint contained both the expressly remanded derivative Rule 10b-5 claim, as well as the unadjudicated pendent state law claims against Ayres for fraud, civil conspiracy, tortious interference with the corporate governance rights of SPS, and breach of fiduciary duties. Although the district court clearly had the power to adjudicate Plaintiff's pendent state law claims against Ayres (*Gibbs*, 383 U.S. at 727), both the district court and the Fifth Circuit refused to acknowledge the pendency of Plaintiff's pendent claims.

Finally, the Fifth Circuit's opinion is contrary to the policy of handling pendent claims so that they are not barred by limitations. *See Carnegie-Mellon*, 484 U.S. at 351-52. Here, however, the net effect of the Fifth Circuit's treatment of the pendent claims is to leave Plaintiff with meritorious state law claims against Ayres subject to a plea of limitations.

CONCLUSION

Based on the foregoing, we respectfully request that the Court grant this Petition for Writ of Certiorari, and that the Court then reverse *per curiam*, without further ado, the order and judgment of the Fifth Circuit. Otherwise, this case should be scheduled for plenary briefing and argument.

Respectfully submitted,

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DATED: March 19, 1993.

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APPENDIX A

Andrew L. SMITH, individually and derivatively on Behalf of Smith Protective Services, Inc., Plaintiff-Appellant,

v.

R. Jack AYRES, et al., Defendants,

R. Jack AYRES, Defendant-Appellee.

No. 91-1734.

United States Court of Appeals,
Fifth Circuit.

Nov. 23, 1992.

F. Dean Armstrong, Flossmoor, Ill., for plaintiff-appellant.

Edwin E. Wright, III, Stradley & Wright, Dallas, Tex., for Ayres.

Appeal from the United States District Court for the Northern District of Texas.

Before WISDOM, REYNALDO G. GARZA, and JONES, Circuit Judges.

EDITH H. JONES, Circuit Judge:

Andrew Smith appeals from the district court's dismissal of his class action [sic] securities fraud claim and his stockholder derivative action. We affirm the trial court's decision in all respects.

BACKGROUND

The instant appeal is but another chapter in a protracted internecine feud among Coralie Smith (mother of

Andrew, Clayton, and Mark), Andrew Smith, Clayton Smith, and Mark Smith, principals or former principals of Smith Protective Services (SPS). At this point, Andrew is pursuing Jack Ayres, General Counsel and Director [sic] of SPS, in a derivative suit and as assignee of the company's Rule 10b-5 securities fraud claims. A fuller recitation of the facts may be found in the earlier opinion, in which this court reversed the first dismissal of the shareholder derivative claim and affirmed the dismissal of related claims. *Smith v. Ayres*, 845 F.2d 1360, 1361-63 (5th Cir.1988).

The trial court originally dismissed Andrew's complaint on the grounds that a state court judgment deprived Andrew of his stock ownership in SPS, thereby defeating his standing to bring a derivative action on behalf of SPS. Because the state court judgment had later been reversed by the Texas Court of Appeals, this court remanded the derivative action for further consideration. On remand, Ayres reasserted his claim that Andrew lacked standing to bring a derivative action on behalf of SPS. The district court granted the supplemental motion to dismiss, ruling that Andrew was not an adequate or proper shareholder representative to bring a class action. [sic] Fed.R.Civ.P. 23.1.

Andrew alternatively claims standing based on his status as a putative assignee of securities fraud claims against Ayres. As part of the settlement agreement between Andrew and SPS (referred to by the parties as the Smith Family Peace Treaty), SPS expressly assigned any and all claims against Ayres to Andrew and granted Andrew the right to sue as assignee of such claims. Andrew retained one of the 10,000,000 shares in SPS.

Under the settlement agreement, Andrew was to have no other benefits of ownership; Andrew could not participate in management, could not vote his share, could not bring other derivative suits, and was obliged to reconvey the single share to SPS if the share became unnecessary to maintain the derivative action against Ayres. In sum, Andrew's single share of stock was granted to him for the sole purpose of generating federal standing in his action against Ayres. The trial court rejected this basis for standing, ruling that Rule 10b-5 securities fraud actions are not assignable.

STANDING AS A DERIVATIVE PLAINTIFF

In order to bring a derivative action, the shareholder plaintiff must "fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association." Fed.R.Civ.P. 23.1. Determining whether the plaintiff meets this standard is firmly committed to the discretion of the trial court, reviewable only for abuse. *Zeidman v. J. Ray McDermott & Co., Inc.*, 651 F.2d 1030, 1040 (5th Cir. Unit A 1981); *see also Larson v. Dumke*, 900 F.2d 1363, 1364 (9th Cir.), *cert. denied*, ___ U.S. ___, 111 S.Ct. 580, 112 L.Ed.2d 585 (1990).

Andrew's current stake in the corporation is infinitesimal; he holds 1/10,000,000 of the authorized shares. More significantly, he receives no cooperation from Mark and Clayton in his persistent litigation efforts against Ayres. Indeed, Mark and Clayton, the remaining two SPS shareholders, vigorously deny the essential allegations that form the basis for this suit, which Andrew must

prove to prevail. The trial court may properly consider the degree of support a would-be shareholder plaintiff will receive from other shareholders in determining the adequacy of representation under Rule 23.1. *See Larson*, 900 F.2d at 1368.

Andrew argues that the test of adequate representation is not whether he can adequately represent all shareholders, but whether he can adequately represent all shareholders similarly situated to himself. Since Mark and Clayton are not similarly situated, he argues that he is a class of one. Only in the rarest instances may there be a shareholder derivative action with a class of one. Such circumstances were manifest in *Larson*, in which the plaintiff was the original owner and founder of a pizza franchise operation who had sold most of his interest to others, but retained an interest of almost 25 percent. He opposed the institution of an Employer Stock Option Plan by some of the new owners and was the only stockholder who elected not to participate.

Larson filed a derivative action to force rescission of the plan, but was not joined by any other shareholders because they would lose money should the suit succeed. With great difficulty, and taking care to limit its holding to the narrow and precise facts before it, the Ninth Circuit allowed Larson to proceed as a class of one. *Larson*, 900 F.2d at 1369. Andrew's situation is entirely distinct. Andrew was not the individual who created, nurtured, and operated SPS from inception. He retained only a negligible interest in SPS. Moreover, in *Larson*, the other shareholders were opposed to Larson's suit because Larson's success would ultimately injure them financially whether or not it benefitted the corporation. Such is not

the case here. Mark and Clayton, principals and owners of virtually 100% of SPS, simply fundamentally disagree with Andrew on what is good for the corporation.

A plaintiff in a shareholder derivative action owes the corporation his undivided loyalty. The plaintiff must not have ulterior motives and must not be pursuing an external personal agenda. Whether or not such a personal agenda exists is determined by the trial court, and we will not reverse its determination absent clear error. In deciding this question, the court may properly consider the amount of the plaintiff's stake in the corporation as balanced against his interest and how the litigation may affect his external interests. *Blum v. Morgan Guaranty Trust Co.*, 539 F.2d 1388, 1390 (5th Cir.1976); *see also Halsted Video, Inc. v. Guttillo*, 115 F.R.D. 177, 180 (N.D.Ill.1987).

Andrew has an unmistakable personal and professional dispute with Ayres. His brief is peppered with vituperative epithets, pugilistic metaphors, and descriptions of Ayres as "satanic" and "evil." Andrew and Ayres are on opposite sides of the emotionally charged feuds between the Browning and the Holloway families. Ayres represents the Brownings' interests and Andrew represents the Holloways' interests. A catalog of the various lawsuits between these two parties and their affiliates would consume well over a full page. *See generally In the Matter of Holloway*, 955 F.2d 1008 (5th Cir.1992); *Browning v. Navarro*, 923 F.2d 377 (5th Cir.1991). While those lawsuits bear no direct relationship to the instant case, they suggest the virulent antagonism Andrew holds for Ayres. The trial court may properly consider the plaintiff's vindictiveness toward the defendant in determining whether

the plaintiff is an adequate representative of the stockholders. *See Davis v. Comed, Inc.*, 619 F.2d 588, 593-94 (6th Cir.1980). For example, Andrew has stated that he is committed to "ruin ten years of [Ayres' life], because I'm going to be sure that Pat Holloway prevails . . . and he – if he thinks this is even the end of the tenth round, I mean we're – we're not even in the first round." As was stated in *Blum*, the trial court should beware allowing a derivative suit to proceed where the "representative could conceivably use the derivative action as 'leverage' in other litigation. . . . " *Blum*, 539 F.2d at 1390. The district court did not abuse its discretion in concluding that Andrew does not qualify as a fair and adequate representative of shareholder interests under Rule 23.1.

ASSIGNMENT OF SPS'S 10b-5 CLAIM

Andrew also claims standing on the basis of the express assignment of SPS's right to sue Ayres. Andrew argues that the generally accepted rule of non-assignability of Rule 10b-5 claims is not applicable to the instant case because he received a direct and express assignment and does not rely on an automatic assignment which travels with his single share of stock.[1] As far as we can tell, Andrew's is a novel claim. Ayres responds that 10b-5 claims are personal and may never be assigned. Ayres warns of dire consequences if we accept Andrew's argument, suggesting that to allow the assignment to

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[1] Indeed, Andrew's "ownership" of a single share of stock has no bearing on the assignability of the Rule 10b-5 action. His stock share may crack open the door to a derivative action, but the assignment must rise and fall on its own.

create standing would presage the development of a futures market in Rule 10b-5 claims.

The guidepost case determining standing rules for 10b-5 actions is *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975). The *Blue Chip Stamps Court* adopted the venerable *Birnbaum* Rule, established in *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956, 72 S.Ct. 1051, 96 L.Ed. 1356 (1952), in which the Second Circuit restricted Rule 10b-5 actions to persons who are either purchasers or sellers of securities. *Blue Chip Stamps*, 421 U.S. at 730-31, 95 S.Ct. at 1917. The *Blue Chip Stamps* decision was intended to tightly restrict the availability of Rule 10b-5 actions. Many courts have relied upon this premise to hold that 10b-5 actions are not automatically assigned when the security is sold. *See, e.g., In re Nucorp Energy Securities Litigation*, 772 F.2d 1486, 1490 (9th Cir.1985); *Soderberg v. Gens*, 652 F.Supp. 560, 564 (N.D.Ill.1987); *In re Saxon Securities Litigation*, 644 F.Supp. 465, 470-72 (S.D.N.Y. 1985); *Rose v. Arkansas Valley Environmental & Utility Authority*, 562 F.Supp. 1180, 1189 (W.D.Mo.1983). Only one court has held an express assignment of a 10b-5 claim to be valid. *AmeriFirst Bank v. Bomar*, 757 F.Supp. 1365, 1371 (S.D.Fla. 1991). The Court of Appeals for the Second [sic] Circuit has opined in dicta that an express assignment does not violate the strict construction philosophy of *Blue Chip Stamps*. *Lowry v. Baltimore & Ohio R.R. Co.*, 707 F.2d 721 (3d Cir.) (*en banc*) (eight member panel produced three opinions, six of the eight judges recognized at least the possibility of an express assignment), *cert. denied*, 464 U.S. 893, 104 S.Ct. 238, 78 L.Ed.2d 229 (1983). *See also*, Note, *Express v. Automatic Assignment of*

Section 10b Causes of Action, 1985 Duke L.J. 813, 823 (express assignment is not inconsistent with strict purchase-or-sale rule of *Blue Chip Stamps*).

The *Blue Chip Stamps* decision to narrow Rule 10b-5 standing was based principally on two policy considerations, both of which guide our decision. First, the Court looked to Congressional intent behind section 10(b) of the Securities Exchange Act of 1934. The Court found that Congress was concerned with blackmail, nuisance, and strike suits, and drafted the Act to circumscribe the class of plaintiffs who may sue under the Act for the very purpose of eliminating such suits. 421 U.S. at 740-41, 95 S.Ct. at 1927-28. The Court's second concern centered on the evidentiary problems inherent in allowing a non-purchaser or non-seller to bring a Rule 10b-5 action. 421 U.S. at 741-43, 95 S.Ct. at 1928-29. The Court was particularly concerned that such suits would turn on "self serving testimony . . . , protracted discovery, [and bear] little chance of reasonable resolution by pre-trial process." *Virginia Bankshares, Inc. v. Sandberg*, ___ U.S. ___, ___, 111 S.Ct. 2749, 2765, 115 L.Ed.2d 929 (1991) (citing *Blue Chip Stamps*, 421 U.S. at 742-43, 95 S.Ct. at 1928-29). The district court noted that "a particular concern here is the risk that this derivative action will be used as a weapon in Andrew's arsenal rather than a device for the protection of all shareholders" and that "Andrew's personal antagonisms are a major motivation behind this lawsuit." In sum, this action bears all the hallmarks of a strike or nuisance suit, the very actions which the *Blue Chip Stamps* decision seeks to reduce or eliminate. Moreover, Andrew must tackle potentially insuperable evidentiary obstacles in proving the merits of his case. Mark and

Clinton [sic], the two majority shareholders in SPS, have unequivocally denied the allegations that form the crux of Andrew's suit. Andrew must necessarily rely heavily on his own "self-serving testimony," and the action bears "little chance of reasonable resolution by pre-trial process."

An assignee, Andrew falls squarely within the type of remote purchasers whose 10b-5 actions are discouraged by *Blue Chip Stamps* and later decisions relying thereon. This court has previously held that Andrew was not affected by any fraud because he voted against issuing shares to Clayton, the action complained of in this suit. *See Ayres,* 845 F.2d at 1364. Andrew secured the assignment of SPS's claims against Ayres and maintains "ownership" of a single share of stock for the express purpose of defeating doctrines which otherwise would preclude his standing to bring this action. His hope is in vain; form will not triumph over substance here. *See Goldberg v. Touche Ross & Co.,* 531 F.Supp. 86, 88 (S.D.N.Y.1982) (assignment of 10b-5 action could not be used to defeat federal law prohibiting indemnity actions under Rule 10b-5).

CONCLUSION

We need not resolve and reserve for another day whether under other circumstances, some Rule 10b-5 claims may be expressly assigned. In this case, however, the trial court did not err in dismissing the claim based upon the purported assignment of the Rule 10b-5 action where the assignment appeared to have been made for

the purpose of creating standing and pursuing a vexatious lawsuit. Nor did the court abuse its discretion in finding that Andrew was not a proper class action [sic] representative.[2] Andrew's request that the case be reassigned on remand to a different district court judge is without merit but in any event mooted by our affirming the judgment of dismissal.

AFFIRMED.

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[2] Andrew's state law claims are not properly before this court having been dismissed earlier in the action and such dismissal upheld by a prior panel. *See Smith v. Ayres*, 845 F.2d at 1366 (dismissal of all claims affirmed save only the derivative claim).

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

ANDREW L. SMITH, Plaintiff,	)	CIVIL ACTION NO. CA 3-85-2628-G
VS.	)	
R. JACK AYRES, ET AL., Defendants.	)	

MEMORANDUM ORDER

(Filed April 12, 1991)

This case is before the court on the supplemental motion of defendants R. Jack Ayres, Jr., and R. Jack Ayres, Jr., P.C. ("Ayres") to dismiss, for want of standing, the shareholder derivative suit brought against them by plaintiff Andrew L. Smith ("Andrew"). For the reasons stated below, Ayres' motion is granted.

I. Background

Andrew brought this shareholder derivative action on behalf of Smith Protective Services ("SPS"), a family-owned corporation that specializes in home protection and security services. In 1977, Andrew was the president and chairman of the board of SPS and owned approximately 26 percent of the corporation's stock. The other owners were his mother, Coralie Smith ("Coralie"), 22 percent, and his brothers, Clayton Smith ("Clayton") and Mark Smith ("Mark"), with 26 percent each.

In June, 1977, Andrew accused Clayton of embezzling money from the business and the corporation filed suit. Ayres, as SPS' general counsel and director [sic], represented the corporation. In the settlement of that suit, the corporation released any claim it had against Clayton in exchange for Clayton's agreement to sell his stock back to SPS. After completing the stock redemption, Andrew and Mark each held 35 percent of the outstanding shares, while Coralie held 30 percent. With their combined majority stake, Andrew and his mother had effective control.

Andrew alleges that in 1983 Clayton set about to recover his interest in the company, and enlisted the support of Mark and Ayres. Clayton's plan, according to Andrew, was to force the board to reissue Clayton's shares in the company under the theory that the prior settlement agreement had been obtained by fraud. For this purpose Clayton retained Gerry Wren, a Dallas lawyer. Clayton intended to have Wren send a letter demanding return of his shares.

On July 20, Clayton related his plan to Ira Tobolowsky, another Dallas attorney who served as an SPS director. The next day, July 21, Tobolowsky telephoned Ayres twice to discuss Clayton's demand letter. Tobolowsky later called Wren's office and learned that Wren had left town without sending the letter. In a conference call that included Tobolowsky, Wren's secretary, and Ayres, Tobolowsky told Ayres that Wren had not sent the letter. Ayres then dictated a letter to Wren's secretary. When Wren's secretary learned that the recorder had

failed to record, she called Tobolowsky. Tobolowsky initiated another conference call, and Ayres successfully dictated the letter to another secretary.

Later the same day, Ayres received the demand letter which bore Wren's signature and which was typed on his firm's stationery. Ayres presented the letter to the board of directors and recommended that the board accede to Clayton's demands. Ayres did not disclose, however, that he was the author of the letter. The Board followed Ayres' recommendation by a vote of 7-2 [sic], with only Andrew and Coralie opposed. The decision gave Clayton and Mark a 52% interest in the corporation. According to Andrew, they have used this control to mismanage the corporation and divert corporate assets for personal gain.

When in February 1986, Andrew entered a plea of "no contest" to an indictment alleging cocaine possession, SPS filed suit in state court to divest Andrew of his shares in the corporation under a Texas law that assertedly prohibits felons from owning an interest in a licensed security agency. A Texas district court granted SPS an injunction requiring Andrew to sell his shares back to the corporation. This decision was reversed on October 21, 1987 by the Texas Court of Appeals. The appellate court found that SPS had no standing to seek the injunction because SPS was attempting to enforce a state agency rule that only the agency could enforce.

As originally filed by Andrew, this suit alleged that Clayton, Mark and Ayres violated the antifraud provisions of Rule 10b-5 of the securities laws (Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b); Rule 10b-5, 17 C.F.R. § 240, 10b-5) as well as the Racketeer

Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-68 ("RICO"). This court dismissed Andrew's individual 10b-5 claim, reasoning that because Andrew voted against rescission, he could not have relied on the letter and thus could not allege the element of reliance. This court also held that Andrew had no standing to bring a derivative securities claim on behalf of the corporation because of the state court decision divesting Andrew of his shares in SPS; at that time the decision was still pending before the state court of appeals. This court dismissed Andrew's RICO claim for failure to plead two or more predicate acts of racketeering as required by the statute.

On appeal from this court's decision, the Fifth Circuit affirmed the dismissal of Andrew's individual 10b-5 claim as well as the RICO claim. Because the state court of appeals had, while the appeal of this case was pending, reversed the state district court's injunction requiring Andrew to sell his shares back to SPS, the Fifth Circuit reversed this court's dismissal of Andrew's shareholder derivative action and remanded it for further proceedings. Smith v. Ayres, 845 F.2d 1360 (5th Cir. 1988).

II. Analysis

Rule 23.1 of the Federal Rules of Civil Procedure establishes the pleading requirements for shareholders pursuing derivative actions. The rule also dictates when a shareholder may not sue as a derivative plaintiff to enforce the right of a corporation:

> The derivative action may not be maintained if it appears that the plaintiff does not fairly and

> adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association.

An adequate representative must have the capacity to vigorously and conscientiously prosecute a derivative suit and be free from economic interests that are antagonistic to the interests of the class. Larson v. Dumke, 900 F.2d 1363, 1367 (9th Cir.), *cert. denied*, ___ U.S. ___, 111 S.Ct. 580 (1990); Owen v. Modern Diversified Industries, Inc., 643 F.2d 441, 443-44 (6th Cir. 1981); Blum v. Morgan Guaranty Trust Company of New York, 539 F.2d 1388, 1390 (5th Cir. 1976). "Should any 'ulterior' motives of plaintiffs which are inimical to their ability to adequately represent the other shareholders become manifest, the Court is free to make appropriate adjustments." First American Corporation v. Foster, 51 F.R.D. 248, 250 (N.D.Ga. 1970).

A particular concern here is the risk that this derivative action will be used as a weapon in Andrew's arsenal rather than a device for the protection of all shareholders. *Blum*, 539 F.2d at 1390. The three current shareholders in SPS are Andrew, Mark, and Clayton. Of the currently authorized ten million shares of SPS stock, Andrew holds only one share, ostensibly to give him standing to prosecute this suit. Andrew's ability to fairly and adequately represent Mark and Clayton's interest *vis a vis* SPS is questionable, however, in light of the fact that Mark and Clayton were originally named as defendants. In addition, the exhibits and history of this litigation indicate that Andrew, Mark, and Clayton have been struggling for control of SPS for some time, and that Andrew does not

believe SPS can function as a viable business unless he is in control of the corporation.

The record also indicates that Andrew's personal antagonisms are a major motivation behind this lawsuit. Andrew and Ayres represented opposing sides in a series of lawsuits, regarding which Andrew testified:

> . . . I decided, you know, since, you know, he [Ayres] was going to ruin five years of my life that I'm going to ruin ten of his, because I'm going to be sure that Pat Holloway prevails. And anybody who would just spitefully try to put one on me like this, it's not going to be over with until it's over with. And he – if he thinks this is even the end of the tenth round, I mean we're – we're not even first round.

Deposition of Andrew L. Smith at 185-86 (Exhibition 31 to Ayres' Supplemental Motion to Dismiss).

Besides expressing a desire to use this suit as another "round" in his personal boxing match, Andrew in his deposition repeatedly refers to Ayres as insane, evil, or possessed by a satanic spirit. *Id.* at 187, 270.

The extraneous, personal motivations behind this lawsuit clearly outweigh any benefit Andrew seeks to confer upon Mark and Clayton. Andrew seems to recognize as much in his responsive brief, arguing that rather than representing the interests of Mark and Clayton, he represents the interests of "members similarly situated" to himself, which – under the circumstances here – is a set whose only member is Andrew: "Since Andrew is the only shareholder similarly situated, he by necessity fairly and adequately represents the interests of himself and meets the qualifications of Rule 23.1" (Plaintiff's

Response at 19). If the court were to accept this reasoning, Rule 23.1 would be rendered meaningless, for any plaintiff in a derivative suit could circumvent the fair and adequate representation requirement by claiming to represent him- or herself as the only member similarly situated.

In *Owen*, 643 F.2d at 443-44, the Sixth Circuit affirmed a district court's holding that a plaintiff in a derivative suit could not fairly and adequately represent other shareholders when he owned only 24 shares whose value did not exceed $21.00, but also owned debentures of the same corporation with a face value of $34,900. By the same token, Andrew – a plaintiff who owns a negligible amount of stock in SPS, is openly antagonistic toward the other shareholders in the corporation, and has strong personal reasons for prosecuting the lawsuit against the named defendant – cannot fairly and adequately represent the interests of other shareholders as required by Rule 23.1.*

---

* Regardless of Andrew's status as a shareholder in SPS, he may not sue as the assignee of the other shareholders' derivative claims [sic]. A 10b-5 plaintiff must prove not only that he is a purchaser or seller of securities, Blue Chip Stamps v. Manor Drug Store, 421 U.S. 723 (1975), but also that the purchase or sale was "in connection with" the fraud of which the plaintiff complains. *See* Superintendent of Insurance of the State of New York v. Bankers Life and Casualty Company, 404 U.S. 6, 10, 12 (1971). A 10b-5 plaintiff must demonstrate "both *loss causation* – that the misrepresentations or omissions caused the economic harm – and *transaction causation* – that the violations in question caused the [plaintiff] to engage in the transaction in question. Schlick v. Penn-Dixie Cement Corp., 507 F.2d 374, 380 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975). *See also* Huddleston v.

In Cohen v. Beneficial Industrial Loan Corporation, 337 U.S. 541, 549 (1949), the Supreme Court noted the fiduciary nature of the relationship between the plaintiff in a shareholder derivative action and the other shareholders that plaintiff represents:

> Likewise, a stockholder who brings suit on a cause of action derived from the corporation assumes a position, not technically as a trustee perhaps, but one of a fiduciary character. He sues, not for himself alone, but as representative of a class comprising all who are similarly situated. The interests of all in the redress of the wrongs are taken into his hands, dependent upon his diligence, wisdom and integrity.

The court is not convinced that Andrew can rise to the status of a fiduciary with respect to the interests of his brothers Mark and Clayton, given his clearly expressed antagonisms toward them and the named defendant, and his negligible stake as a shareholder in tbe corporation.

Herman & MacLean, 640 F.2d 534, 549 n.24 (5th Cir. 1981), *aff'd in part, rev'd in part,* 459 U.S. 375 (1983). This requirement extends to assignees of 10b-5 claims. In re Saxon Securities Litigation, 644 F.Supp. 465, 470 (S.D.N.Y. 1085). "If a 10b-5 claim could be assigned, whether implicitly or otherwise, the purchaser/seller requirement might be effectively abridged. Remote purchasers who were never touched by any fraud would have standing to assert the claims of the defrauded purchser/seller." *Id.*

Andrew is such a remote purchaser. The Fifth Circuit has already determined that he was not touched by any fraud because he voted against issuing shares to Clayton. *See Ayres,* 845 F.2d at 1364. Accordingly, Andrew is not the proper assignee of the other shareholder's 10b-5 claims [sic].

III. Conclusion

Because Andrew has not met the requirement of fair and adequate representation set out in Rule 23.1 of the Federal Rules of Civil Procedure, the court is unwilling to allow him to continue prosecution of this shareholder derivative action. Accordingly, Ayres' supplemental motion to dismiss is hereby GRANTED.

SO ORDERED.

April 12, 1991.

/s/ A. Joe Fish
A. JOE FISH
United States District Judge

APPENDIX C

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

ANDREW L. SMITH,	§	CIVIL ACTION NO.
Plaintiff,	§	CA3-85-2628-G
	§	
vs.	§	
R. JACK AYRES, JR., et al.,	§	
Defendants.	§	

JUDGMENT

(Filed July 10, 1991)

For the reasons stated in the Court's April 12, 1991 Memorandum Order granting the Supplemental Motion to Dismiss of Defendants R. Jack Ayres, Jr. and R. Jack Ayres, Jr., P.C.,

It is hereby ORDERED, ADJUDGED and DECREED that Plaintiff take nothing by this action, and that Defendants recover their costs of court.

It is further ORDERED that the Clerk shall transmit a true copy of this judgment to counsel of record.

~~June~~ July 9, 1991.

/s/ A. Joe Fish
A. JOE FISH
United States District Judge

Supreme Court, U.S.
FILED
APR 20 1993
OFFICE OF THE CLERK

NO. 92-1534

In The

Supreme Court of the United States

October Term, 1992

ANDREW L. SMITH,
Petitioner,

v.

R. JACK AYRES, JR.,
Respondent.

On Petition for Writ of Certiorari To The United States Court of Appeals For the Fifth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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April 21, 1993

ISSUE PRESENTED

Whether the Fifth Circuit correctly affirmed the district court's dismissal of Andrew Smith's derivative action for Smith Protective Services under Rule 10b-5 of the Securities and Exchange Commission for want of standing.

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No. 92-1534

In The
Supreme Court of the United States
October Term, 1992

ANDREW L. SMITH,
Petitioner,

v.

R. JACK AYRES, JR.,
Respondent.

RESPONDENT'S BRIEF IN OPPOSITION

TO THE HONORABLE UNITED STATES SUPREME COURT:

The Respondent R. JACK AYRES, JR., ("Ayres") respectfully requests that this Honorable Court deny the Petition for Writ of Certiorari of Andrew L. Smith ("Andrew") seeking review of the decision of the United States Court of Appeals for the Fifth Circuit which is reported at 977 F.2d 946 (5th Cir. 1992).

JURISDICTION

Petitioner claims jurisdiction under 28 U.S.C. §1254.

STATEMENT OF THE CASE

This case is the remnant of the federal-court offshoot of a protracted, bitter intra-family dispute among Andrew, Coralie Smith, Andrew's mother, and Andrew's two brothers, Clayton and Mark Smith, over control of a family business, Smith Protective Services, Inc. (SPS)[1]. The petition represents Andrew's attempt to create federal jurisdiction for a derivative suit against Ayres, a Texas attorney who is a former general counsel for SPS.

Prior to March 1976, 100% of the stock ownership in SPS was held by Andrew's father (also named Andrew Smith), its founder, his wife, Coralie, and their three sons. In March 1976, the father died. Eventually his stock ownership in SPS passed through his estate to his widow Coralie and his three sons, but in September 1977, his stock was still held by his estate.

Prior to September 1977, Clayton was an officer, director, and shareholder of SPS. In 1977, Andrew, then President of SPS, accused Clayton of wrongfully taking corporate funds from SPS and had Ayres file suit for SPS against Clayton. In September 1977, Andrew personally negotiated a settlement of SPS's claims with Clayton under which Clayton would sell his SPS stock to SPS and resign all positions with SPS. Andrew, who was then and is now, a licensed attorney, drafted part of the documents reflecting the purported purchase by SPS. SPS's purported purchase of Clayton's stock was never formally ratified, authorized, or approved by the shareholders or directors of SPS. No stock certificates were issued, transferred, or signed over as part of the 1977 transaction involving Clayton's stock. Clayton, Andrew, Coralie and Mark signed the settlement documents in September 1977. However, no one signed the stock purchase agreements on behalf of the father's estate, and the estate was not a party to the purported transaction.

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[1] Andrew's statement of the case is riddled with inaccuracies and self-serving conclusions and statements. It is necessary to discuss the actual facts leading up to this suit to understand the decisions of the lower courts and to correct the inaccurate impressions left by Andrew's petition.

By 1983, Clayton had been rehired by SPS, promoted to vice-president and was a member of the board of directors. At that time, SPS had a nine-member board of directors consisting of Coralie, Andrew, Mark, Clayton and five non-family members who included Shelby Denny, who was then President of SPS, and Ira Tobolowsky. Tobolowsky, a licensed attorney and a close friend of Andrew, was also chairman of the SPS Litigation Committee, which oversaw litigation and coordinated litigation and potential litigation matters involving SPS with Ayres.

Clayton approached Denny about having the purported September 1977 purchase of his stock by SPS rescinded on the grounds that it had never actually been properly concluded and was a nullity or, alternatively, on the ground that it had been fraudulently induced by Andrew. Clayton contended that Andrew, who had served in the capacity of an attorney for SPS, Clayton, and other members of the Smith family, had breached his fiduciary duties to Clayton in the prior transaction. By letter dated May 5, 1983, Clayton personally made demand that Andrew, Coralie, and Mark return his SPS stock to him.

Denny referred Clayton to Ayres, as general counsel for SPS, and to Tobolowsky, as an SPS director and head of the SPS Litigation Committee. Clayton also made demand upon Ayres and Tobolowsky for the return of his stock in SPS which had been the subject matter of the September 1977 purported stock purchase. Ayres suggested that Clayton hire an attorney to present his claims to SPS. Clayton retained Gerry Wren, a Dallas attorney recommended independently by both Ayres and Tobolowsky, to represent him in connection with his claims against SPS. On behalf of Clayton, Wren contacted both Ayres and Tobolowsky. During these contacts, Wren orally set forth the nature and substance of the claims and demands being asserted by Clayton against SPS. One of the demands which Clayton was making on SPS in July 1983 was for the rescission or cancellation of the purported September 1977 stock purchase and the return to Clayton of his stock in SPS. Wren orally asserted this demand on behalf of Clayton to Ayres and

Tobolowsky. Wren further asserted the urgency of having SPS act quickly upon Clayton's claims in order to avoid litigation.

Wren was advised that Clayton's claims would be presented to SPS's Board of Directors for consideration at a meeting scheduled for July 22, 1983. Wren agreed to provide, at the request of Tobolowsky and Ayres, a letter prior to the July 22, 1983 directors meeting which would set forth in writing the reasons for Clayton's demand that the September 1977 purported stock purchase be rescinded. The purpose of this demand letter was to enable the SPS Board of Directors to have Clayton's claims and demands reduced to writing so that SPS's board could consider those claims and demands at its scheduled meeting.

Prior to noon on July 22, 1983, Tobolowsky contacted Ayres and advised him that no demand letter had been received from Wren. Tobolowsky was concerned that if no demand letter was received, the Board of Directors would have nothing in writing regarding Clayton's claims to take up at the scheduled Board of Directors meeting later that day. Tobolowsky was also concerned that Wren might get in trouble with Clayton for failure to deliver the promised letter on time. Therefore, Tobolowsky initiated a conference call with Ayres to Wren's offices to inquire as to the status of the demand letter.

Ayres and Tobolowsky were advised in that call by Wren's legal assistant, Donna DeLozier, that Wren had not yet prepared the demand letter, that Wren was at that time out of the office, and that Wren was out of contact with his office. During this telephone conference, Tobolowsky, acting as a member of the SPS Board of Directors and as chairman of the SPS Litigation Committee, directed Ayres, as general counsel for SPS, to supply Wren's legal assistant with language setting out the substance of Clayton's claims and demands. The purpose of supplying such language to Wren's legal assistant was so that she could prepare the requested demand letter on Wren's behalf.

At Tobolowsky's direction and with him listening, Ayres provided to Wren's legal assistant the language to use in preparing the requested demand letter. When Tobolowsky was informed later that the dictation equipment at Wren's office

failed, he made a second call to Ayres and had Ayres redictate the language while Tobolowsky again listened in. On both occasions, Tobolowsky was not only fully aware of Ayres providing such language to Wren's legal assistant, but also assisted in supplying such language. There is no dispute that the language supplied by Ayres accurately set forth the oral demands which had previously been made to Ayres and Tobolowsky by Wren on Clayton's behalf. Wren himself subsequently reviewed and approved the letter and its language before it was hand-delivered to the SPS Board of Directors.

Meanwhile, Mark and several non-family members of the Board met prior to the SPS board meeting to discuss their views of Clayton's demands. They informally agreed that Clayton should have his SPS stock back.

When the matter of Clayton's claims was reached by the Board of Directors at the July 22, 1983 meeting, Clayton excused himself from the meeting. Wren's letter was provided to the Board to set forth the substance of Clayton's claims and demands. Ayres gave his opinions and advice to the Board, and Andrew gave his opposing opinions and view of Clayton's claims. The Board voted 5 to 2 with two abstentions (one being Clayton) to rescind the purported 1977 purchase of Clayton's stock by SPS. Andrew and Coralie voted against the resolution.

As a result of this Board action, SPS's books reflected that Clayton, Mark and Andrew each held 26% of the outstanding SPS stock and Coralie held 22%. Clayton and Mark subsequently voted together to effectively control SPS's management and Clayton became the President of SPS. Clayton subsequently directed Ayres to sue Andrew as a conspirator in a pending Texas state-court lawsuit against other family members for attempting to appropriate trademarks belonging to SPS. In response, Andrew filed counterclaims in the state-court suit seeking to set aside the Board of Directors' rescission of SPS's purported 1977 purchase of Clayton's stock. Complex state litigation followed between the Smith family members.

While the state-court cases were pending, Andrew filed this suit in federal court on December 31, 1985 against Clayton,

Mark and Ayres. He alleged a personal claim and a derivative action for SPS against Ayres and his brothers for violating Rule 10b-5 and the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§1961-68 ("RICO").

The district court originally dismissed Andrew's complaint on the grounds that he failed to state a claim for himself and that a state-court judgment which deprived Andrew of his ownership of SPS stock defeated his standing to bring a derivative action on behalf of SPS. On appeal, the Fifth Circuit affirmed the dismissal of Andrew's federal claims except for the derivative action for SPS against Ayres. *Smith v. Ayres*, 845 F.2d 1360 (5th Cir. 1988). Because the state-court judgment had later been reversed by the Texas Court of Appeals, the Fifth Circuit remanded the derivative action against Ayres for further consideration.

Andrew's derivative suit is predicated entirely upon Ayres' actions in supplying language for the July 22, 1983 demand letter ("the Wren letter"). Andrew has alleged that the assertion of Gerry Wren's authorship of the Wren letter is a prohibited false or misleading act or practice under Rule 10b-5, notwithstanding the fact that Wren approved the letter prior to its delivery to SPS and notwithstanding the fact that the Wren letter accurately set forth the claims and demands then actually being made by Clayton against SPS.

Andrew asserts that on the basis of this alleged false assertion of authorship, rather than the substance of Clayton's claims themselves, the SPS Board of Directors voted to rescind the abortive 1977 purchase by SPS of Clayton's SPS stock and to return Clayton's SPS stock to him. The principal damaging effect of this transaction to SPS, according to Andrew, is that it transferred effective control of the stock of SPS from Andrew and his mother (and family ally) Coralie, to a rival family block consisting of Andrew's brothers, Clayton and Mark, whom Andrew alleges mismanaged the corporation and brought about lost value and lost profits to SPS.

Following the remand of this case, Andrew and Coralie entered into a settlement of all their claims against SPS, Clayton

and Mark on or about December 19, 1989. In that settlement, SPS purchased all of Coralie's SPS stock and also all of Andrew's stock, allegedly except for "one share." At the conclusion of the settlement, the only shareholders in SPS (other than the "one share" allegedly held temporarily by Andrew under the settlement agreement) were Mark and Clayton. The sole purpose of Andrew's purported retention of "one share" was to enable him to continue the derivative suit against Ayres.

The settlement documents executed by Coralie, Andrew, Clayton, Mark and SPS provided:

> Smith Protective Services, Inc. shall have an option to purchase the remaining share from Andrew L. Smith for 1 cent, said option to be exercisable upon the final judgment or date it is determined, under Texas and federal law, that ownership of said share is unnecessary to maintain the said derivative suit. Andrew L. Smith agrees to bring no other derivative suits and to not exercise any shareholder's rights pursuant to the ownership of this single share other than the continuation of the existing derivative suit against R. Jack Ayres, Jr.

It would be difficult to imagine a more blatant attempt to artificially manufacture federal standing and jurisdiction than that which Andrew has attempted in this case through the use of the state-court settlement. There are presently ten million shares of SPS stock authorized, each with a par value of 1 cent per share. Andrew's "one share," even if valid, therefore, represents 1/10,000,000 or 0.0000001% of the total ownership of SPS.

The settlement documents also assigned to Andrew any of SPS's claims or causes of action against Ayres including the right to substitute SPS's name for Andrew's in the federal derivative suit. Prior to that settlement, however, on May 24, 1989 and May 31, 1989, the Board of Directors of SPS, after the filing of this suit and with full knowledge of Ayres' role in supplying language for the Wren letter,[2] unanimously ratified and approved the 1983 rescission of the September 1977 pur-

ported purchase of Clayton's SPS stock. The Board of Directors at the time of the ratification consisted of Clayton, Mark and Bill Cue, all of whom were also directors at the time of the July 22, 1983 board meeting.

Despite such developments in the state litigation, Andrew never amended his pleadings in this case following the remand from the Fifth Circuit. The sole jurisdictional basis alleged is his Rule 10b-5 derivative suit on behalf of SPS against Ayres. Under Andrew's current pleadings, the damages alleged by Andrew on behalf of SPS are due to the alleged mismanagement of SPS by Clayton and Mark after they took control of SPS. Under the state-litigation settlement agreement, however, Andrew's one share of stock does not entitle him to the ordinary rights of stock ownership, including the right to share in any proceeds to SPS from this litigation.[3]

Under the current pleadings of this case, therefore, the only persons who would profit from a recovery by SPS of damages which Andrew alleges that SPS has suffered would be the very people -- Mark and Clayton -- whom Andrew alleges caused the damages and toward whom Andrew has demonstrated

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[2] Ira Tobalowsky testified that he told other directors, including Coralie and Mark, about Ayres' role in supplying language for use in preparing the July 22, 1983 demand letter within a month after the July 22, 1983 Board meeting. Andrew himself has alleged that in January 1984, he became aware of Ayres' role in supplying language for use in preparing the demand letter, and that he advised the officers and directors of SPS of these facts. (Plaintiff's Second Amended Complaint.)

[3] Andrew's right to share in the proceeds of this litigation would exist, if at all, only to the extent that the purported assignment validly assigns SPS's claims to Andrew. Apart from the assignment, Andrew would have no right, solely on the basis of his "shareholder" status, to participate in any SPS recovery in this case.

open hostility.[4] In short, Andrew has no economic stake or incentive in the outcome of this lawsuit as pled.

Why then would Andrew go to such elaborate lengths to try to keep this derivative suit against Ayres alive or from collapsing under the weight of the state-court settlement? Aside from the open hostility between Andrew and his brothers,[5] there are two readily apparent reasons demonstrated from the record in this case, neither of which have anything to do with SPS, but both of which are instead personal to Andrew.

First, it would be difficult to underestimate Andrew's personal hostility toward Ayres. Andrew's comments about Clayton are rather mild compared to his comments about Ayres. Under oath, Andrew has testified that Ayres is "possessed by some satanic spirit," has "psychological problems," is "probably insane," has "gone off on . . . grand delusions," "if there's anybody in the world who is [possessed by satanic spirits], that Mr. Ayres is just about as bad a person," "like Adolph Hitler, he thinks he can do anything," has "got the Midas touch syndrome," "is evil," and "is by far the most evil doer I have ever experienced so far in my life." Andrew, in short, wants to continue this litigation putatively "on behalf of SPS" but, in fact, simply as a continuation of his personal vendetta against Ayres. The Fifth Circuit points out that Andrew's brief, before it was "peppered with vituperative epithets, pugilistic, metaphors, and descriptions of Ayres as 'satanic' and 'evil'." 977 F.2d at 949.

Secondly, Andrew figures in yet another titanic struggle for the control of a business with which the federal courts and Texas state courts are painfully familiar: the *Browning v. Holloway* dispute in which Ayres has long served as an attorney for the

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[4] Andrew has sworn under oath that Clayton is a "sociopath" and is either "insane or possessed by satanic spirits." He has characterized Mark as "just a weak individual."

[5] Allowing Andrew to continue with this lawsuit would allow him to keep the proceeds of the state-court settlement with SPS based upon mismanagement and other misdeeds by Clayton and Mark, and yet still continue to embarrass his brothers by continuing to make those same allegations within the context of this suit.

Browning family interests.[6] Andrew has served as an attorney for and assisted Pat Holloway and/or his wife, Robbie Holloway, in several of the Holloway's never-ending series of lawsuits against the Brownings and anyone else connected with that litigation in any capacity (including judges and attorneys). Andrew makes no effort to hide his desire to use this case as a vehicle for advancing his personal agenda in the Holloway litigation. In connection with that representation, Andrew has testified under oath:

> I decided, you know, since, you know [Ayres] was going to ruin five years of my life that *I'm going to ruin ten of his*, because I'm going to be sure that Pat Holloway prevails. And anybody who would just spitefully try to put one on me like this, it's not going to be over with until it's over with. And he -- if he thinks this is even the end of the tenth round, I mean we're -- *we're not even finished with the first round.* (original emphasis).

Hence, Andrew has the incentive of using this litigation to harass Ayres to try to gain additional concessions in the Holloway litigation, or to use this suit as leverage in the Holloway litigation. *See Smith v. Ayres*, 977 F.2d at 949.

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[6] See, e.g., *Holloway v. Starnes*, 840 S.W.2d 14 (Tex. App. - Dallas 1992, writ denied); *Starnes v. Holloway*, 779 S.W.2d 86 (Tex. App. - Dallas 1989, writ denied); *Browning v. Ryan*, 756 S.W.2d 379 (Tex. App. - Dallas 1988) (orig. proceeding), *rev'd, Holloway v. Fifth Court of Appeals*, 767 S.W.2d 680 (Tex. 1989); *Browning v. Placke*, 698 S.W.2d 362 (Tex. 1985); *Humble Exploration Co. v. Browning*, 677 S.W.2d 111 (Tex. App. - Dallas 1984), *dism'l reinstated*, 690 S.W.2d 321 (Tex. App. - Dallas 1985, writ ref'd n.r.e.)(en banc), *cert. denied*, 574 U.S. 1065, 106 S.Ct. 1376, 89 L.Ed. 2d 602 (1986); *Browning v. Navarro*, F.2d 377 5th Cir. 1991); *Browning v. Navarro*, 887 F.2d 553 (5th Cir. 1989), *reh'g denied*, 894 F.2d 99 (5th Cir. 1990); *Browning v. Navarro*, 826 F.2d 335 (5th Cir. 1987); *Browning v. Navarro*, 743 F.2d 1069 (5th Cir. 1984), rev'g *Browning v. Navarro* 37 B.R. 201 (N.D. Tex. 1983); *Holloway v. Walker*, 784 F.2d 1287 (5th Cir. 1986), *reh'g denied*, 790 F.2d 1170, *cert. denied*. 479 U.S. 984, 107 S.Ct. 571, 93 L.Ed. 2d 576 (1986); *Holloway v. Walker*, 800 F.2d 479 (5th Cir. 1986) (Bolivian consul matter); *Holloway v. Walker*, 811 F.2d 236 (5th Cir. 1987) (sanctions); *In re Holloway*, No. 91-1541 (5th Cir. Jan. 27, 1992) (bankruptcy appeal); *Flojo Trading Corp. v. Browning*, No. 3-91-256-Cv (Tex. App.-Austin July 1, 1992, no writ); *Jachne v. Starnes*, No. 14,693 (Tex. App.-Austin September 23, 1987, writ ref'd n.r.e.).

When the district court had originally dismissed this case, it had not considered all of Ayres' arguments. Therefore, following the remand, Ayres renewed the unaddressed arguments and added Andrew's lack of standing to pursue a derivative suit by having sold his SPS stock, except for his alleged retention of "one share." Ayres alternatively moved for summary judgment. In opposition, Andrew contended that as an "owner" of "one share" of SPS stock, he represented all similar shareholders - i.e., himself. Andrew also argued in the alternative that he had standing to sue as an assignee of SPS. The district court granted Ayres' Motion to Dismiss, and the Fifth Circuit affirmed.

REASONS FOR DENYING THE WRIT

I. ANDREW LACKS STANDING TO REVIEW ISSUES NOT ALLEGED IN HIS COMPLAINT.

Andrew's only live complaint at the time the district court dismissed this case for the second time was one simple allegation - a Rule 10b-5 derivative suit for SPS. Andrew never amended his complaint to allege standing as an assignee of SPS. Ayres pointed out that deficiency to the lower courts. While both the lower courts also addressed Andrew's assignee claims, the central focus was on Andrew's standing to pursue a derivative suit as an "owner" of "one share" of SPS's 10,000,000 shares.

The issues Andrew asks this Court to address have nothing to do with the only remaining allegations actually contained in this complaint. Because federal courts are courts of limited jurisdiction, Andrew as the plaintiff had the burden to establish that jurisdiction in his complaint. Because he failed to do so, he has not preserved for review the issues he seeks to present to this Court.

II. THIS CASE TURNS ON ITS OWN FACTS AND WILL AFFECT FEW OTHERS THAN THE LITIGANTS.

Neither of the courts below sought to enunciate any significant ruling to control regular shareholder derivative suits or Rule 10b-5 suits. Both courts focused on the narrow facts involving the protracted internecine feud between Andrew and his brothers, as well as Andrew's "virulent antagonism" towards Ayres.

Andrew's so-called retained "ownership" of "one share" of SPS stock is a transparent sham transaction executed solely to attempt to manufacture federal jurisdiction. As such, his suit is barred by 28 U.S.C. §1359. Andrew never addresses this fraud in his petition. The decisions of the lower courts concern the right of a person who retains "ownership" in name only of one share out of 10,000,000 shares in a family-owned company for the express purpose of creating standing to bring a derivative suit purportedly on behalf of the corporation, when he is, in fact, openly antagonistic to the real owners of the company. Obviously, the rulings in this case are not going to apply to many, if any, other litigants. Indeed, Andrew himself recognizes that the decisions below are fact sensitive and fact determinative.

The lower court's analysis of Andrew's purported assigned claims was likewise restricted to this particular factual situation. The Fifth Circuit specifically held:

> We need not resolve and *reserve for another day whether under other circumstances*, some Rule 10b-5 claims may be expressly assigned. In this case, however, the trial court did not err in dismissing the claim based upon the purported assignment of the Rule 10b-5 action where the assignment appeared to have been made for the purpose of creating standing and pursing a vexatious lawsuit.

977 F.2d at 950-51 (emphasis added).

III. THERE IS NO CONFLICT BETWEEN THE FIFTH CIRCUIT AND THIS COURT OR OTHER COURTS OF APPEALS.

Not once in his petition does Andrew show how the Fifth Circuit's opinion is in conflict with a prior opinion of this Court. In fact, in its opinion, the Fifth Circuit specifically focuses upon the policy considerations addressed at great length by this Court in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed 2d 539 (1975). The Fifth Circuit then applies those policy considerations to the unique facts of this case. Thus, the Fifth Circuit's opinion is clearly consistent with, rather than in conflict with, this Court's *Blue Chip Stamps* opinion.

Andrew also fails to show a real conflict between the Fifth Circuit and other circuits on the same matter of law or fact; rather, he merely identifies inconsistencies in dicta or in the general principles utilized. The closest potential conflict Andrew cites is *Lowry v. Baltimore & Ohio R.R. Co.*, 707 F.2d 721 (3rd Cir.)(en banc), *cert. denied*, 464 U.S. 893, 104 S.Ct. 238, 78 L.Ed. 2d 229 (1983). In *Lowry* a badly divided court issued a per curiam opinion accompanied by five separate opinions of various members of the court. In their various opinions, a majority opined in dicta that an express assignment does not violate the philosophy of *Blue Chip Stamps*. No definitive holding to this effect was actually made by the *Lowry* court. Moreover, the factual situations in *Lowry* did not involve transactions intended for the sole purpose of fraudulently conferring federal jurisdiction. Hence, *Lowry* and this case are clearly distinguishable.

In *Blue Chip Stamps*, this Court noted its history of permitting the lower courts to thoroughly analyze the applicability of 10b-5 claims before addressing such issues itself. 421 U.S. at 730-31, 95 S.Ct. at 1922-23. Such an approach provides this Court with the benefit of the wisdom and intellect of many experienced judges. Andrew now asks this Court to address his issues without the benefit of such prior analysis. Such issues are not ripened in this case to an appropriate stage for this Court's review.

IV. THE FIFTH CIRCUIT DID NOT DENY ANDREW ANY RIGHT TO A MEANINGFUL APPEAL.

Andrew also asks this Court to grant certiorari on the premise that the Fifth Circuit has somehow denied him a meaningful review of the district court's dismissal of his case. He complains mightily but vaguely about the Fifth Circuit's analysis of the policy considerations expressed by this Court in *Blue Chip Stamps* and their application to the jurisdictional facts in this case. In essence, Andrew contends that the Fifth Circuit's analysis of the law must not deviate from the analysis of the district court or the arguments presented by Ayres. Such a contention is preposterous. It is well established that a court of appeals can affirm a correct decision of a district court for even a completely different reason than that given by the district court. *Riley v. Commissioner*, 311 U.S. 55, 59, 61 S.Ct. 95, 97, 85 L.Ed. 36 (1940).

Moreover, Andrew had ample notice that he needed to address the policy considerations espoused in *Blue Chip Stamps*. In his supplemental motion to dismiss and brief in the district court, Ayres devoted the bulk of his argument to Andrew's lack of standing as a stockholder because that was the only basis for jurisdiction in Andrew's alleged derivative suit. In the event that Andrew might seek to amend his complaint in light of his state-litigation settlement, Ayres also addressed Andrew's standing as an assignee. Ayres specifically identified this Court's writing in *Blue Chip Stamps* "about the sound policy reasons for carefully restricting the class of 10b-5 plaintiffs to purchasers and sellers." Ayres then argued that the assignment of 10b-5 claims are particularly inappropriate where the assignment is made solely to attempt to create standing to a non-qualified 10b-5 plaintiff. Ayres repeated this same argument to the Fifth Circuit in his brief while at the same time pointing out Andrew's personal hostility towards Ayres, his conflicts with his brothers, the current owners of SPS who Andrew claims damaged SPS through mismanagement, as well as the utter frivolousness of Andrew's claims against Ayres for acting under the direction of the Chairman of the SPS Litigation

Committee. Andrew had ample opportunity to address the applicability of the *Blue Chip Stamps* policies to the facts of this case before the Fifth Circuit. There is no reason to burden this Court with what would be a simple review of a lower court's analysis.

V. ANDREW'S PENDENT STATE CLAIMS PROVIDE NO BASIS FOR THIS COURT'S REVIEW.

Finally, Andrew complains that the lower courts erred by not readdressing his pendent state-court claims which had been dismissed without prejudice in the district court's original dismissal. In Andrew's first appeal, the Fifth Circuit reversed only the district court's dismissal of Andrew's derivative action for SPS against Ayres. *Smith v. Ayres*, 845 F.2d at 1365. The remainder of the district court's decision was affirmed. 845 F.2d at 1364-66. By his third issue, Andrew seeks in this second appeal to request a review of the Fifth Circuit's decision in the prior appeal. His request is untimely; such a review should have been sought in the first appeal.

Even if Andrew's pendent state claims were somehow automatically resurrected by its Fifth Circuit's reversal of one narrow federal claim, the courts below were not required to continue to entertain such claims when they decided that last remaining basis for federal jurisdiction had ended. See 28 U.S.C. §1367(c)(3); *United Mine Workers of America v. Gibbs*, 383 U.S. 715, 726, 86 S.Ct. 1130, 1139, 16 L.Ed. 2d 218 (1966).

Andrew acknowledges that his state law claims against Ayres are now barred by Texas rules of limitations. Andrew has only himself to blame. He could have avoided this result by timely filing a state court suit against Ayres within sixty (60) days following the district court's original dismissal of his federal claims. Tex. Civ. Prac. & Rem. Code §16.064. This Court cannot be expected to grant certiorari in a case of this type for the sole purpose of enabling Andrew to avoid the applicable rules of limitations. See *Reed v. Allen*, 286 U.S. 191,198-99, 52 S.Ct. 532,533,76 L.Ed. 1054 (1932).

CONCLUSION

For these reasons, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of April, 1993, three copies of Respondent's Brief in Opposition were mailed, postage prepaid, to Mr. F. Dean Armstrong, Law Offices of F. Dean Armstrong, P.C., 639 Perth Avenue, Flossmoor, Illinois 60422. I further certify that all parties required to be served have been served.

EDWIN E. WRIGHT, III

Supreme Court, U.S.
FILED
MAY 11 1993
OFFICE OF THE CLERK

No. 92-1534

In The

Supreme Court of the United States

October Term, 1992

ANDREW L. SMITH,

Petitioner,

v.

R. JACK AYRES, JR.,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

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This is the Reply Brief of Petitioner Andrew L. Smith ("Andrew") to the Brief in Opposition submitted by Respondent R. Jack Ayres, Jr. ("Ayres").

AYRES HAS NOT PROVIDED A FAIR SUMMARY OF THE FACTS

This case was not tried and the district court did not grant a motion for summary judgment. Rather, the district court dismissed Plaintiff's Complaint pursuant to the Defendant's Supplemental Motion to Dismiss. (A2). The facts as summarized in Andrew's Petition for Writ of Certiorari are fully supported by the allegations set forth in Plaintiff's Second Amended Complaint and the summary judgment evidence submitted by Plaintiff in opposition to Defendant's Motion for Summary Judgment.

Ayres' Brief in Opposition does not provide the Court with a fair summary of the facts. Not only did Ayres ignore the tape recorded conversations involving Clayton and Ayres confirming the scheme to reissue SPS stock to Clayton, Ayres put his own spin on the facts surrounding the Wren Letter fraud and otherwise failed to draw all reasonable inferences in Plaintiff's favor as required by *H.J., Inc. v. Northwestern Bell Telephone Co.*, 492 U.S. 229, 249-50 (1989) and *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255 (1986).

Pursuant to Supreme Court Rule 15.1, a brief in opposition

> should address any perceived misstatements of fact or law set forth in the petition which have a bearing on the question of what issues would

> properly be before the Court if certiorari were granted. . . . Counsel are admonished that they have an obligation to the Court to point out any perceived misstatements *in the brief in opposition*, and not later.

See, also, Rules 15.2 & 24.2. Although Ayres makes the global claim that "Andrew's statement of the case is riddled with inaccuracies and self-serving conclusions and statements" (Brief in Opposition p. 2 n. 1), Ayres does not cite the Court to a single inaccuracy, a single omission, or a single misrepresentation in Andrew's Petition.

Instead of pinpointing any alleged inaccuracies or misstatements in Andrew's Statement of the Case, Ayres engages in wholesale revisionism with a full gloss of lame excuses, limp explanations, and ludicrous extenuating circumstances, all of which are contrary to the allegations in Plaintiff's Complaint and Plaintiff's summary judgment evidence. But even with Ayres' inaccurate recharacterization of the facts, there are some matters which Ayres simply can't explain. For example, Ayres can't explain why he inserted the bogus 5:00 p.m. deadline in the demand letter which he wrote to himself (the "Wren Letter") when no such purported deadline had been discussed with Clayton, Mr. Wren or anyone else, and why he used this phony deadline to stampede the SPS directors into immediate and uninformed action toward reissuing SPS stock to Clayton.

Indeed, in his slanted Statement of the Case Ayres has maneuvered through the facts like an enemy soldier crawling through a mine field. And for good reason. Ayres knows that he got caught red-handed orchestrating

an ingenious stock fraud scheme to shift control of SPS away from Andrew and his mother to Clayton and Mark, and is only hoping for a technicality to escape accountability for his fraudulent conduct. We respectfully request our day in court to prove our claims against Ayres.

I. ANDREW NEED NOT AMEND HIS COMPLAINT TO ASSERT AN ASSIGNED CLAIM

Without citation to any authorities, Ayres argues that because Andrew did not amend his complaint to assert standing as assignee of the claims of SPS, "he has not preserved for review the issues he seeks to present to this Court." (Brief in Opposition p. 11). Ayres is wrong.

In Plaintiff's Response to Defendant's Supplemental Motion to Dismiss, Andrew specifically informed the district court of the assignment to Andrew of SPS' claims against Ayres and that Andrew had standing to pursue SPS's securities fraud claims under that express assignment. Further, Fed.R.Civ.P. 25(c) provides that when there has been a transfer or assignment of an interest in a case,

> the action may be continued by or against the original party, unless the court upon motion directs the person to whom the interest is transferred to be substituted in the action or joined with the original party.

"The most significant feature of Rule 25(c) is that it does not require that anything be done after an interest has been transferred." 7C Wright, Miller & Kane, *Federal Practice and Procedure* §1958 p. 555 (1986).

II. THE FIFTH CIRCUIT'S DECISION IS NOT ONLY WRONG IN THIS CASE, IT IS BAD LAW

Ayres argues that this case is not worthy of review by this Court because "[n]either of the courts below sought to enunciate any significant ruling to control . . . Rule 10b-5 suits." (Brief in Opposition p. 12). Ayres is wrong.

As part of the settlement of Andrew's claims against SPS, Clayton and Mark, SPS expressly assigned its claims against Ayres to Andrew and granted Andrew the right to sue as assignee of such claims. The trial court dismissed Plaintiff's complaint, not because of some unique fact issue pertaining to the case, but because it was of the erroneous opinion that "Rule 10b-5 securities fraud actions are not assignable." (A3).

The Fifth Circuit affirmed the erroneous decision of the trial court by applying a novel fact-sensitive test gleaned from *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975). While the answers to the two questions posed by the Fifth Circuit in determining the assignability of a Rule 10b-5 claim do turn on the facts of each case, the erroneous analytical test announced by the Fifth Circuit in *Smith v. Ayres II* would bring into question the validity of every assignment of every Rule 10b-5 claim.

The slippery slope subjective test announced by the Fifth Circuit only beclouds an aspect of Rule 10b-5 litigation which deserves clarification and elucidation. *See Lowry v. Baltimore & Ohio R.R. Co.*, 707 F.2d 721 (3d Cir. 1983) (*en banc*), *cert. den'd*, 464 U.S. 893 (1983). As noted by Judge Hoeveler:

> The concerns expressed in *Blue Chip* are not present in the case at bar. Permitting [plaintiff] a cause of action under Rule 10b-5 based on the express assignment from the settlement class will not encourage "strike" suits. The Class members were purchasers and sellers who allegedly were injured by the fraudulent actions of Defendants. Allowing [plaintiff] to litigate a portion of these claims on the Class's behalf does not make the suit a "nuisance". Nor does an express assignment by one who has standing to sue introduce the evidentiary problems present in *Blue Chip*. In this case, those persons who were allegedly defrauded can testify that they relied on a specific misrepresentation or omission when they bought or sold their securities.

AmeriFirst Bank v. Bomar, 757 F.Supp. 1365, 1372 (S.D.Fla. 1991).

III. THE FIFTH CIRCUIT'S OPINION IS IN CONFLICT WITH DECISIONS OF THIS COURT, AND THIS CASE INVOLVES IMPORTANT QUESTIONS OF FEDERAL LAW WHICH SHOULD BE RESOLVED BY THIS COURT

Next Ayres argues that this case is not certworthy because Andrew supposedly failed to show either (a) "how the Fifth Circuit's opinion is in conflict with a prior opinion of this Court" or (b) "a real conflict between the Fifth Circuit and other circuits on the same matter of law or fact." (Brief in Opposition p. 13). Again Ayres is wrong.

First, on pages 14, 21 and 22 of Andrew's Petition we did show how the Fifth Circuit's affirmance of the result

of the district court based on two fact-sensitive considerations not argued by the Defendant or utilized by the district court in invalidating the assignment is in conflict with this Court's decisions in *Fountain v. Filson*, 336 U.S. 681, 683 (1949); *Florida Lime and Avocado Growers, Inc. v. Paul*, 373 U.S. 136, 156 (1963); and *Byrd v. Blue Ridge Rural Electric Cooperative*, 356 U.S. 525, 533 (1958). Moreover, this Court in *Blue Chip Stamps* held that in order to maintain 10b-5 standing, the plaintiff must qualify as an actual "purchaser" or "seller" of securities. 421 U.S. at 731. Because *Blue Chip Stamps* did not address the issue of whether a plaintiff with purchaser-seller standing could assign its Rule 10b-5 claim, *Smith v. Ayres II* does not constitute a technical conflict with *Blue Chip Stamps*. Nevertheless, in affirming the dismissal of Plaintiff's Complaint the Fifth Circuit applied the *Blue Chip Stamps* purchaser-seller limitation to a situation where it was not intended to apply (*AmeriFirst*, 757 F.Supp. at 1370-72; *Gardner v. Surnamer*, 608 F.Supp. 1385, 1390 (E.D.Pa. 1985); *see, generally*, Note, *Express Versus Automatic Assignment of Section 10(b) Causes Of Action*, 1985 Duke L.J. 813, 823 & 828-30 (1985)), which is roughly tantamount to a conflict on point.

And second, we never argued that there was a conflict between the Fifth Circuit and the other circuits on the issues raised in the Petition. Rather, under the guidelines set forth in Supreme Court Rule 10.1(c), we argued that (1) the question of the assignability of a Rule 10b-5 securities fraud claim; and (2) the question of the power of the district court to entertain a plaintiff's pendent

claims along with the expressly remanded federal question claim, are important questions of federal law which have not been, but should be, settled by this Court.

IV. THE FIFTH CIRCUIT ERRONEOUSLY AFFIRMED THE RESULT OF THE DISTRICT COURT BASED ON TWO FACT-SENSITIVE CONSIDERATIONS WHICH WERE NOT ARGUED BY THE DEFENDANT OR UTILIZED BY THE DISTRICT COURT IN INVALIDATING THE ASSIGNMENT OF SPS' RULE 10B-5 CLAIMS

While we agree that an appellate court can affirm the decision of a trial court even though the trial court relied on the wrong reason in reaching its result (*Fountain*, 336 U.S. at 683; *Heirs of Fruge v. Blood Services*, 506 F.2d 841, 844 n. 2 (5th Cir. 1975)), an appellate court may not do so where the aggrieved party was not accorded a "full and fair opportunity to develop facts relevant to the decision." *Id. See, also, Florida Lime*, 373 U.S. at 156; *Byrd*, 356 U.S. at 533; *Commissioner of Internal Revenue v. Josephs*, 168 F.2d 233, 237 (8th Cir. 1948).

As admitted by Ayres, "the decisions below are fact sensitive and fact determinative." (Brief in Opposition p. 12). However, we were never given the opportunity to develop facts relevant to the two allegedly dispositive fact-sensitive inquires announced by the Fifth Circuit in *Smith v. Ayres II*. The sua sponte "findings of fact" by the Fifth Circuit denied Plaintiff his day in court as to a disputed part of the case on which the trial court has never ruled. Where this "full and fair opportunity" was not made available, "the proper resolution of the appeal

is not affirmance but remand." *Heirs of Fruge*, 506 F.2d at 844 n. 2.

V. THE FIFTH CIRCUIT AND THE DISTRICT COURT REFUSED TO ACKNOWLEDGE THE PENDENCY OF PLAINTIFF'S PENDENT CLAIMS

Ayres argues that the district court, upon remand from the prior reversal, was not required to "continue to entertain" Plaintiff's pendent claims when the district court decided that the last remaining basis for independent federal jurisdiction had ended. (Brief in Opposition p. 15). We agree. But that is not the situation before the Court. Rather, upon remand the district court simply refused to acknowledge the pendency of Plaintiff's pendent claims.

Ayres claims that Andrew could have avoided any potential statute of limitations problems pertaining to Andrew's pendent claims by the filing of a state court suit against Ayres within 60 days following the district court's original dismissal of Andrew's federal claim. (Brief in Opposition p. 15). However, upon the prior remand, the district court never acknowledged the pendency of Plaintiff's pendent claims. Because the district court never addressed Plaintiff's pendent claims in any order or judgment, we were never given the opportunity to file our pendent claims in state court. Thus, the Fifth Circuit's opinion is contrary to the policy of handling pendent claims so that they are not barred by limitations. *See Carnegie-Mellon University v. Cohill*, 484 U.S. 341, 351-52 (1988).

CONCLUSION

Based on the foregoing, and the reasons set forth in our Petition for Writ of Certiorari, we respectfully request that the Court grant Andrew's Petition for Writ of Certiorari, and that the Court then reverse *per curiam*, without further ado, the order and judgment of the Fifth Circuit. Otherwise, this case should be scheduled for plenary briefing and argument.

DATED: May 11, 1993.

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